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United States
Circuit Court of Appeals

✓rl
2276

For the Ninth Circuit.

PEERLESS STAGES, INC., a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the
United States Board of Tax Appeals.

FILED

OCT - 1 1941

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

PEERLESS STAGES, INC., a Corporation,
Petitioner,

vs.

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Answer	26
Appearances	1
Assignment of Errors.....	103
Certificate	110
Decision	98
Designation of Contents of Record on (Board of Tax Appeals).....	108
Designation of Contents of Record on Review (Circuit Court of Appeals).....	111
Docket Entries	1
Findings of Fact and Opinion.....	94
Notice of Filing Petition for Review.....	106
Opinion	96
Petition	3
Petition for Review.....	99
Praeipce (Board of Tax Appeals).....	108
Review:	
Assignment of Errors on.....	103
Designation of Contents of Record on (Board of Tax Appeals).....	108

Index	Page
Designation of Contents of Record on (Circuit Court of Appeals).....	111
Petition for	99
Praecipe (Board of Tax Appeals).....	108
Statement of Points on (Circuit Court of Appeals)	111
Statement of Points on Review (Circuit Court of Appeals)	111
Stipulation re Exhibits.....	107
Testimony	28
Exhibits for petitioner:	
1—Map of bus routes between Oakland and Hayward, years 1931 to 1935 inclusive	43
2—Statement of profit and loss for year 1931	53
3—Statement of profit and loss for year 1932	56
4—Statement of profit and loss for year 1933	58
5—Statement of profit and loss for year 1934	60
6—Statement of profit and loss for year 1935	64
7—Summary of Oakland-Hayward Division development losses, years 1931 to 1935 inclusive.....	67

Index	Page
Statement of the Case on Behalf of Petitioner	29
Statement of the Case on Behalf of Respondent	38
Witnesses for petitioner:	
Howell, Franklin D.	
—direct	86
Weiser, George J.	
—direct	40
—voir dire	52
—cross	76
Transcript of Hearing of October 10, 1940 (See “Testimony”)	28

APPEARANCES:

For Taxpayer:

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
ALBERT H. DAVIDSON.

For Comm'r:

T. M. MATHER, Esq.

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1939

- Oct. 25—Petition received and filed. Taxpayer notified. Fee paid.
- Oct. 25—Copy of petition served on General Counsel.
- Dec. 12—Answer filed by General Counsel.
- Dec. 12—Request for hearing in San Francisco filed by General Counsel.
- Dec. 15—Notice issued placing proceeding on San Francisco Calendar. Answer and request served.

1940

- May 6—Notice of the withdrawal of Robert H. Perry filed. Consented to by taxpayer.
- May 6—Notice of the appearance of Clyde C. Sherwood, John V. Lewis and Albert H. Davidson, as counsel filed.
- Aug. 13—Hearing set October 7, 1940, San Francisco.
- Oct. 10—Hearing had before Mr. Sternhagen on merits. Submitted. Briefs due in forty days. No reply.
- Oct. 29—Transcript of hearing October 10, 1940, filed.
- Nov. 13—Brief filed by General Counsel.
- Nov. 18—Brief filed by taxpayer. November 18, 1940, copy served on General Counsel.
- Dec. 19—Findings of fact and opinion rendered. Sternhagen. Division 10. Decision will be entered for the respondent.
- Dec. 20—Decision entered. J. M. Sternhagen. Division 10.

1941

- Mar. 11—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.
- July 16—Proof of service filed by taxpayer.
- July 16—Certified copy of an order from the Ninth Circuit extending time to August 12, 1941, filed.

1941

July 17—Designation of the portions of the record, proceedings, and evidence to be contained in the record on appeal filed by taxpayer.

July 26—Stipulation re transmission of Exhibits 1 to 7 filed. [1*]

United States Board of Tax Appeals

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency signed by the Internal Revenue Agent in Charge, San Francisco, dated July 31, 1939 (symbols IRA:90-D/CWB), and as a basis of this proceeding alleges as follows:

1. The petitioner is a corporation organized under the laws of the State of California, with principal office at 401 Pacific Building, Oakland, California.

2. The notice of deficiency, (a copy of which is

*Page numbering appearing at top of page of original certified Transcript of Record.

attached and marked Exhibit "A") was mailed to the petitioner on July 31, 1939.

3. The taxes in controversy are income taxes and excess profits taxes for the calendar year 1936. The deficiency asserted is \$34,899.24, the whole amount of which is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) In determining the taxable net income of the petitioner for the calendar year 1936 the Commissioner erroneously increased the income \$119,705.58.

(b) The Commissioner erred in failing to allow the petitioner a cost basis of \$119,705.57 for the developed operative rights which rights the petitioner agreed to abandon under its agreement with Railway Equipment & Realty Company, Ltd. [2]

(c) In the sale of petitioner's busses and abandonment of operative rights and motor coach lines for which the petitioner received \$216,540.32 the Commissioner erroneously disallowed the capitalization of the cost of development of operative rights.

(d) The Commissioner erred in determining that under the Revenue Act of 1936, the petitioner had no authority to capitalize the cost of development of operative rights, and, also erred in determining that the profit from sale of busses and franchise amounted to \$212,040.32.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

((a) The petitioner entered into an agreement with Railway Equipment & Realty Company, Ltd., hereinafter designated as Equipment Company under date of January 14, 1936 under which petitioner was agreeable to abandoning certain of its motor coach lines and certain of its operative rights upon the performance of all the terms and conditions set forth in such agreement. Copy of said agreement is attached hereto and marked Exhibit "B".

Under the aforesaid agreement the petitioner reported as taxable income in its corporation income and excess profits tax return for the calendar year 1936 a capital gain of \$92,334.74 which amount represented the profit made on abandonment of operative rights. In its accounting records for the calendar year 1935 the petitioner capitalized the sum of \$119,705.58 representing the cost of development of operative rights.

The capitalized cost of \$119,705.58 set up by the petitioner was credited as at December 31, 1935 by journal entry with \$30,000.00 the offsetting charge being made to an account receivable. The total amount received by the petitioner under the agreement \$216,540.32 was therefore applied as [3] follows when received:

\$ 30,000.00 credited to account receivable
\$186,540.32 credited to income

Of the latter amount \$4,500.00 was allocated to income from the sale of busses. The amount of capitalized cost, \$89,705.58 offset against income in the petitioner's tax return for the year 1936 was applicable to years and amounts as follows:

Calendar Year 1931 cost.....	\$15,613.54
Calendar Year 1932 cost.....	11,230.94
Calendar Year 1933 cost.....	516.47
Calendar Year 1934 cost.....	39,459.22
Calendar Year 1935 cost.....	22,885.41
<hr/>	
Total Cost	<u><u>\$89,705.58</u></u>

The amounts restored to surplus in the calendar year 1935 after having been charged off as losses in the accounting records in prior years were as follows:

Calendar Years, 1931.....	\$15,613.54
1932.....	11,230.94
1933.....	516.47
1934.....	39,459.22
<hr/>	
Total.....	<u><u>\$66,820.17</u></u>

As at May 18, 1936 the petitioner remitted the following amounts to the Collector of Internal Revenue, San Francisco, California for purposes as follows:

Additional Income Tax—Year 1931.....	\$ 101.44	
Interest on above.....	25.46	
		<hr/>
Total.....		\$ 126.90
Additional Income Tax—Year 1932.....	\$2,415.94	
Interest on above.....	316.08	
		<hr/>
Total.....		\$2,732.02
Additional Income Tax—Year 1934.....	\$3,269.22	
Interest on above.....	231.57	
		<hr/>
Total.....		\$3,500.79
		[4]

Amended income tax returns for the calendar years 1931 and 1932, and, amended income and excess profits return for the calendar year 1934 were filed with the Collector of Internal Revenue, San Francisco, California on May 18, 1936.

(b) A revenue agent of the Commissioner of Internal Revenue made a field examination of the petitioner's books and accounts for the calendar year 1935. Subsequently under date of January 20, 1937 the petitioner was advised by letter signed by C. W. Herrick, Internal Revenue Agent in Charge, San Francisco, that it was being recommended that the income tax return for 1935 be accepted as correct. At the date of such examination by the revenue agent the accounts of the taxpayer reflected the capitalization of the aforesaid amount of \$119,705.58 and the transfer of \$30,000.00 to an accrued receivable account as at December 31, 1935. The Commissioner did not take exception to the

capitalization of such costs or setting up the accrued receivable pursuant to or as a result of such examination to the best knowledge and belief of officers of the petitioner.

(c) The operative rights of the taxpayer for the operation of motor coach lines were acquired upon application to the Railroad Commission which is the regulatory body in the State of California.

(d) In the application for the acquisition of such operative rights by the petitioner a showing was required that public convenience and necessity demanded the proposed operations and further that such operations could be developed to a profitable basis. During the time of acquiring such rights only nominal costs were incurred. It was known by the officers of the petitioner at the time of acquisition of these rights that it would be necessary to make a considerable expenditure in order to develop the patronage of the motor coach lines operated thereunder. [5]

It therefore undertook a development program and used its capital to invest for a future benefit which actually materialized. The petitioner's officers realized that inasmuch as the petitioner performed no service locally within the City of Oakland, it was dependent, if it wished to develop its operative right, upon the adjacent San Leandro and Hayward territory. Upon a survey of the territory it was found that there was available in this area an abundance of homesites, ideal from point of view of climatic conditions and prices, and it was

also found that unless, frequent, economical transportation services that would provide service for commuters, shoppers, and those attending schools and business, were first provided, the settlement of the communities would be retarded.

The Company accordingly undertook, in 1931, its program of development along a so-called "E. 14th St. route." Local busses, effecting approximately a twenty minute headway between Oakland and Hayward were put into operation. It is essential to note that in the opinion of the officers of the petitioner that those then residing in the area were insufficient by far to warrant the operation of such a service. The service was put on to develop the territory, which in turn would develop an operative right of considerable value. It should be clear that the development program throughout was carried on for the benefit of future years. Exhibit "C" indicates how, under this plan, patronage was gradually attracted to the lines of the carrier during 1931, 1932 and 1933. At this point (the close of 1933) the receipts of the operation had been brought to a point that about equalled the annual expenses of the operation, and the development phase of that operative right was about completed.

However, the Company deemed it advisable in 1934 to embark upon a further program of development by applying to the State Railroad Commission for an operative right to serve the San Lorenzo and Castro Valley areas. These areas [6] are adjacent to the 1931 development program. The deterrent

to settlement in this area was likewise the lack of suitable transportation facilities. This same type of development program was instituted in this area. A twenty minute frequency over the San Lorenzo and Castro Valley routes was instituted, which in turn was co-ordinated with the existing service along E. 14th St., effecting a ten minute service between Hayward, San Leandro and Oakland. Exhibit "C" indicates how the installation of new service began bringing about new development in the area and new passengers to the operation.

The cost of this extra frequency of service over and above immediate needs was not incurred for immediate benefit, but was a definite cost incurred for the benefit of future years.

(e) The Railroad Commission granted the taxpayer the operative rights as hereinbefore described to the exclusion of other carriers and at the inception of the service it was considered by officers of the petitioner that a portion of the company's capital would necessarily be invested in developing the operative rights acquired.

(f) It was considered by officers of the petitioner that annual deficits of operation of bus lines as capitalized represented substantially the cost of development of the operative rights.

(g) It was also considered by officers of the petitioner that had the cost of development of operative rights been established by a segregation of expenses and costs that any incidental profit arising from operation under these operative rights would

be deductible from the development cost. This course of action it was also considered would, in effect, result in cost of development of operative rights equal to or substantially equal to the capitalized cost which the petitioner set up as at December 31, 1935. [7]

(h) The operative rights which the petitioner agreed to abandon in its agreement of January 14, 1936 with the Equipment Company were capital assets. These rights in the consideration of the petitioner's officers became valuable during the process of development of the operative rights.

6. Wherefore, the petitioner prays that this Board may hear the proceeding and determine that no deficiency be due from the petitioner for the calendar year 1936.

ROBERT H. PERRY

Counsel for Petitioner

Robert H. Perry

1706 Broadway

Oakland, California [8]

State of California,
County of Alameda—ss.

G. J. Weiser, being duly sworn deposes and says that he is the secretary of the petitioner above named and that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true, except as to those stated upon

information and belief, and those facts he believes to be true.

G. J. WEISER

Subscribed and sworn to before me this 23rd day of October, 1939.

[Seal] JESSIE MACPHERSON

Notary Public in and for the County of Alameda,
State of California.

My commission expires April 15, 1943. [9]

EXHIBIT "A"

Treasury Department
Internal Revenue Service
433 Federal Office Building
San Francisco, California

July 31, 1939

Office of
Internal Revenue Agent in Charge
San Francisco Division
IRA:90-D
CWB

Peerless Stages, Incorporated,
401 Pacific Building,
Oakland, California.

Sirs:

You are advised that the determination of your income tax liability for the taxable year December 31, 1936 discloses a deficiency of \$25,289.85 and that

the determination of your excess-profits tax liability for the year mentioned discloses a deficiency of \$9,609.39 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting ~~Sunday~~ or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By (Signed) F. M. HARLESS

Internal Revenue Agent in
Charge [10]

Statement

San Francisco

IRA :90-D

CWB

Peerless Stages, Incorporated

401 Pacific Building

Oakland, California

Tax Liability for the Taxable Year Ended
December 31, 1936.

	Liability	Assessed	Deficiency
Income Tax	\$36,923.15	\$11,633.30	\$25,289.85
Excess-profits Tax	9,609.39	None	9,609.39
	<hr/>	<hr/>	<hr/>
	\$46,532.54	\$11,633.30	\$34,899.24

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the report of examination dated May 25, 1938, to your protests dated August 18, 1938 and December 2, 1938; to the statements made at the conferences held on November 1, 1938, January 11, 1939 and May 24, 1939.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by line 27, page No. 2 of return	\$ 85,288.67
Unallowable deductions and additional income	
(a) Gain on sales increased.....	\$119,705.58
(b) Adjustment capital stock tax.....	84.00
	119,789.58
Net income adjusted.....	\$205,078.25

[11]

EXPLANATION OF ADJUSTMENTS

(a) Gain on sale as adjusted.....	\$212,040.32
Gain on sale as reported.....	92,334.74
Gain on sale increased.....	\$119,705.58

It is held that the profit realized from the sale of the busses and franchise to East Bay Railways, Ltd., is \$212,040.32 under the provisions of section 111(a) of the Revenue Act of 1936 and that there is no authority under the provisions of section 113(b) of the Revenue Act of 1936 to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive.

(b) It is held that the correct amount to be deducted for capital stock tax is the amount of \$916.00 and that the deductions claimed in excess of that amount, viz., \$84.00, are not deductible under the provisions of section 23(c) of the Revenue Act of 1936.

COMPUTATION OF TAX

Excess-profits Tax:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Less:

10% of \$1,000,000.00 value of capital stock as declared in your capital stock tax return for the year ended June 30, 1936.....	100,000.00
---	------------

Net income subject to excess-profits Tax.....	\$105,078.25
---	--------------

5% of declared value of capital stock.....	50,000.00
--	-----------

Balance	\$ 55,078.25
---------------	--------------

Excess-profits tax:

6% of \$50,000.00.....	\$ 3,000.00
12% of \$55,078.25.....	6,609.39

Total excess-profits tax.....	\$ 9,609.39
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Excess-profits tax assessed:

Original First California, account No. 402625.....	none
--	------

Deficiency of excess-profits tax.....	\$ 9,609.39
---------------------------------------	-------------

[12]

Income Tax:

Normal Tax:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Less:

Excess-profits tax	9,609.39
--------------------------	----------

Net income for normal tax computation.....	\$195,468.86
--	--------------

8% of \$ 2,000.00 (Over 0 to \$ 2,000).....	160.00
11% of 13,000.00 (Over 2,000 to 15,000).....	1,430.00
13% of 25,000.00 (Over 15,000 to 40,000).....	3,250.00
15% of 155,468.86 (Over 40,000).....	23,320.33

Total normal tax.....	\$ 28,160.33
-----------------------	--------------

Surtax on Undistributed Profits:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Computation of Tax (Cont.)

Less:

Excess-profits tax	\$ 9,609.39	
Normal tax	28,160.33	37,769.72

Adjusted net income.....\$167,308.53

Less:

Dividends paid credit.....	101,000.00	
----------------------------	------------	--

Undistributed net income.....\$ 66,308.53

Less:

Specific credit	none	
-----------------------	------	--

Remainder subject to surtax.....\$ 66,308.53

7% of \$16,730.85.....	\$ 1,171.16	
12% of \$16,730.85.....	2,007.70	
17% of \$32,846.83.....	5,583.96	

Normal surtax

Normal tax

Total income tax (normal tax and surtax).....\$ 36,923.15

Income tax assessed (normal tax and surtax):

Original First California, account No. 402625..... 11,633.30

Deficiency of income tax.....\$ 25,289.85

[13]

EXHIBIT "B"

Agreement

This Agreement, Made this 14th day of January, 1936, by and between Peerless Stages, Inc., a corporation, sometimes hereinafter referred to as "Peerless", and Railway Equipment & Realty Company, Ltd., a corporation, sometimes hereinafter referred to as "Equipment Company",

Witnesseth:

Whereas, Peerless owns and operates a system of motor coach lines and is the holder of certain operative rights, and particularly certain local motor coach lines and operative rights in the County of Alameda, as hereinafter described, and is the owner of certain equipment used in the operation of said service; and

Whereas, East Bay Street Railways, Ltd., a corporation, sometimes hereinafter referred to as "Street Railways", owns and operates a system of street railway and motor coach lines in the Counties of Alameda and Contra Costa, including certain motor coach and street railway lines between the Cities of Oakland, San Leandro and Hayward; and

Whereas, Equipment Company owns the operating equipment leased to and used by Street Railways in said service, and is the owner of all the shares of the capital stock of Street Railways; and

Whereas, Peerless is agreeable to abandoning certain of its motor catch lines and certain of its operative rights upon the performance of all the terms and conditions hereinafter set forth, and desires to sell certain equipment; and

Whereas, Equipment Company desires to purchase said equipment; and

Whereas, the parties hereto have been informed that Street Railways desires to operate a motor coach service over the routes to be abandoned by Peerless and will file an application with the Rail-

road Commission of the State of California for a certificate of public convenience and necessity to operate the same;

Now, therefore, it is hereby agreed by and between the parties hereto as follows:

1. Peerless agrees to abandon all local service ("local service" is herein defined to mean the carrying of passengers between any two points, both original and destination being within the territory described in Exhibit B) and such motor coach routes as are engaged wholly in local service, whether operated by virtue of certificates of public convenience and necessity or by reason of operative rights acquired prior to regulation by the Railroad Commission of the State of California or by permits or franchises from any political subdivision or otherwise, and to discontinue local service on through equipment, said local service and routes being more particularly described in Exhibit A attached hereto and made a part hereof. [14]

Peerless further agrees not to file any tariffs for, engage in, conduct or operate directly or indirectly for itself or its successors or assigns, any local service whatsoever for the transportation of passengers for hire within the territory designated on the map marked "Exhibit B" attached hereto and made a part hereof.

Nothing herein contained is intended to apply to the transportation of express matter or mail nor to charter, contract, freight or taxi service.

2. Peerless agrees to sell, and Equipment Company agrees to buy, fifteen (15) thirty-seven pas-

senger motor coaches no longer required in the public service by Peerless, said motor coaches being more particularly described in Exhibit C attached hereto and made a part hereof.

3. Equipment Company agrees to pay to Peerless the sum of One Hundred Eighty Thousand Dollars (\$180,000.00), and to further pay to Peerless an additional sum of Thirty Thousand Dollars (\$30,000.00), which said last mentioned sum is to be paid to Peerless as reimbursement on Peerless' local service operating deficit for the period from April 1, 1935 to December 31, 1935; also to pay to Peerless an additional sum equal to the local service operating deficit of Peerless from January 1, 1936 to the date of actual abandonment of local service by Peerless as authorized by orders of the Railroad Commission of the State of California, and granting a certificate or certificates of public convenience and necessity to Street Railways to operate local service, as hereinafter provided. The operating deficit last referred to shall be based upon an agreed operating expense of twenty cents (20¢) per coach mile; mileage to be computed on route trip miles as set forth in Exhibit A.

The payments to be made by Equipment Company to Peerless shall be made in the following manner:

(a) Upon the execution of this agreement, One Hundred Thousand Dollars (\$100,000.00) shall be deposited in escrow with Wells Fargo Bank and Union Trust Co., San Francisco, California, and

shall be paid to Peerless upon presentation to said bank of the following documents:

1. Copy of order of the Railroad Commission of the State of California authorizing the abandonment of local service by Peerless, as described in Exhibit A attached hereto, certified by the Railroad Commission as a true copy.

2. Copy of the acceptance of Peerless of the abandonment order filed with the Railroad Commission, certified by the Railroad Commission as a true copy.

3. Copy of the Railroad Commission's order granting to Street Railways a certificate of public convenience and necessity to operate the service described in Exhibit E attached hereto, certified by the Railroad Commission as a true copy. [15]

4. A bill of sale covering the fifteen (15) motor coaches described in Exhibit C attached hereto, together with duly enclosed certificates of registration therefor.

(b) One Hundred Ten Thousand Dollars (\$110,000.00) and the total of the deficit from January 1, 1936 to date of abandonment by Peerless and the commencement of operation by Street Railways, as herein provided, shall be paid to Peerless ninety (90) days after the payment of said One Hundred Thousand Dollars (\$100,000.00).

Equipment Company shall have the right to audit the books of Peerless to determine the operating deficit hereinbefore referred to.

4. Immediately upon the execution of this agreement, and concurrently with Street Railways, as hereinafter provided, Peerless shall file, or cause to be filed, with the Railroad Commission of the State of California an application for authority to abandon all local service as described in Exhibit A, said application to be in the form set forth in Exhibit D attached hereto and made a part hereof.

Equipment Company agrees to cause Street Railways to file with the Railroad Commission of the State of California, concurrently with Peerless as hereinbefore provided, an application for a certificate or certificates of public convenience and necessity to operate motor coach service over all the routes to be abandoned by Peerless, except those for which Street Railways now holds a certificate or certificates of public convenience and necessity, said application to be in the form of Exhibit E attached hereto and made a part hereof.

It is assumed by both parties hereto, and both parties hereto agree to request that the Railroad Commission will so make its orders on the application of Peerless and the application of Street Railways respectively, that it will be possible for Peerless to comply with the requirements of the order of the Railroad Commission, such as notice to the public, etc., and abandon local service at the close of one day and Street Railways commence service at the start of the next succeeding day. Peerless agrees to comply with the order of the Railroad Commission, when, as and if issued on Peerless' said application, as soon as possible under the requirements

of said order after said order is issued. Whenever in this agreement the words "the effective date of said Commission's orders", or similar words having the same meaning, appear, it is mutually agreed that the date referred to is the first date that Peerless may lawfully abandon service under the requirements of any order or orders of said Railroad Commission given on Peerless' said application.

5. Immediately upon the effective date of said orders of the Railroad Commission, Peerless agrees to withdraw its application now pending before the Railroad Commission of the State of California seeking an operative right on San Leandro Street, being Application No. 20326.

6. The fifteen (15) motor coaches to be sold by Peerless to Equipment Company shall be delivered to Equipment Company, or its nominee, and Equipment Company agrees to accept said motor coaches at either Oakland or Hayward, at the close of business on the date of said abandonment by Peerless. Said fifteen (15) motor coaches shall be delivered free and clear of all liens and encumbrances, and said purchase shall not be deemed an assumption by Equipment Company or Street Railways of any liability, indebtedness, obligation, claim, demand, action or cause of action of any nature whatsoever attached to, incidental to, or arising [16] out of, the ownership or operation of said equipment by Peerless; and Peerless hereby covenants and agrees to save harmless and indemnify Equipment Company and Street Railways, or either, from all, or

any, of said liabilities, obligations, claims, demands, actions or causes of action whatsoever.

7. In the event said motor coach service is abandoned by Peerless, as hereinbefore provided, and Street Railways, operates a motor coach service over said, or any of said routes, as hereinbefore provided, said operation by Street Railways shall not be deemed an assumption by Street Railways or Equipment Company, or any of their affiliated companies, or their successors or assigns, of any liability, indebtedness, obligations, claim, demand, action, or cause of action, of any nature whatsoever attached to, incidental to, or arising out of the sale or issue of any ticket, token, pass or other medium of fare, or the operation of any motor coach service by Peerless; and Peerless hereby covenants and agrees to save harmless and indemnify Equipment Company and Street Railways from all or any of said liabilities, obligations, claims, demands, actions or causes of action whatsoever.

8. In the event the Railroad Commission of the State of California should fail to make either of the orders hereinabove referred to, as prayed for, within sixty (60) days from the date heretof, this agreement shall become null and void.

9. This agreement is expressly made for the benefit of Street Railways.

10. This agreement shall be binding upon the parties hereto and upon their successors and assigns.

In witness whereof, said parties hereto have

caused this agreement to be executed in duplicate by its proper officers who are thereunto duly authorized.

PEERLESS STAGES, INC.

by JOS. B. HELD (Signed)

President

Attest:

G. J. WEISER (Signed)

Secretary

Peerless Stages, Inc.

(Seal)

RAILWAY EQUIPMENT &
REALTY CO., LTD.

by A. LUNDBERG (Signed)

Attest:

ANGUS CLARK (Signed)

Secretary [17]

Railway Equipment &
Realty Company, Ltd.

(Seal)

EXHIBIT "C"

PASSENGER & EXPRESS REVENUES AND
MILEAGE—BY YEARS

Years 1931 to 1935 Inclusive

Year	Passenger and Express Revenues	Annual Mileage
(1) 1931	\$ 48,356.91	282,127
1932	58,230.04	328,860
1933	63,355.05	342,513
(2) 1934	101,640.22	753,967
1935	108,550.72	839,046

(1) Development undertaken through addition of local service

and busses along E. 14th St. route.

- (2) Additional development undertaken through addition of local service and busses along San Lorenzo and Castro Valley routes.

[Endorsed]: U.S.B.T.A. Filed Oct. 25, 1939. [18]

[Title of Board and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. (a) to (d), inclusive. Denies that the determination of tax set forth in the said notice of deficiency is based upon errors as alleged in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition. [19]
5. (a) Admits that the petitioner entered into an agreement with the Railway Equipment and Realty Company, Ltd., under date of January 14,

1936, under which petitioner was agreeable to abandoning certain of its motor coach lines and certain of its operative rights upon the performance of all the terms and conditions set forth in such agreement, and that petitioner reported as taxable income by virtue of said agreement in its corporation income and excess profits tax return for the calendar year 1936 a capital gain of \$92,334.74. Denies the remaining allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that a revenue agent of the Commissioner of Internal Revenue made a field examination of the petitioner's books and accounts for the calendar year 1935. Denies the remaining allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) to (h), inclusive. Denies the allegation contained in subparagraphs (d) to (h), inclusive, of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied. [20]

Wherefore, it is prayed that the Commissioner's determination be approved and that the petitioner's appeal be denied.

[Signed] J. P. WENCHEL

TMM

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

HARRY R. HORROW,

Special Attorneys,

Bureau of Internal Revenue.

HRH/vg 12/6/39

[Endorsed]: U. S. B. T. A. Filed. Dec. 12, 1939

[21]

United States Post Office and Court House,
San Francisco, California,

October 10, 1940. 10:55 a. m.

Before: Hon. John M. Sternhagen.

Met pursuant to notice.

Appearances:

Clyde C. Sherwood and John V. Lewis, 333 Montgomery Street, San Francisco, California, appearing for Peerless Stages, Inc., Petitioner.

T. M. Mather, appearing for the Commissioner of Internal Revenue, Respondent. [23]

Proceedings

The Member: Docket No. 100436, Peerless Stages, Inc. Who appears for the petitioner?

Mr. Sherwood: Ready for the petitioner. Clyde C. Sherwood and John V. Lewis appearing for the petitioner.

The Member: You are Mr. Sherwood?

Mr. Sherwood: I am Mr. Sherwood, and this is Mr. Lewis (indicating).

The Member: And for the respondent?

Mr. Mather: T. M. Mather.

The Member: Proceed, sir.

Statement of Case on Behalf of Petitioner.

Mr. Sherwood: The issue in this case, your Honor, is one that has been before the Board on two or three occasions in matters involving newspaper circulations, and particularly in the Houston Gas Company case. In other words, the question is whether money expended for a development constitutes ordinary losses to be deducted in the taxable year in which they were expended, or whether they are to be capitalized as capital investments. But in this particular case the petitioner prior to 1931 was operating a bus line, a commercial bus service between Oakland, California, San Jose, and Santa Cruz.

The Member: Is that the year in question, 1931?

Mr. Sherwood: No. The year in question, your Honor, is 1936, and the question is whether the losses sustained in 1931, 1932, 1933, 1934 and 1935

[25]

are to be considered deductible losses in those respective years, or whether they are to be considered as capital investments, because in 1936 the company sold out this particular development and realized thereon a considerable sum of money, in fact, about twice as much as we are attempting to capitalize as an investment.

The Member: What am I to understand you mean by "development"; this particular development?

Mr. Sherwood: I was going to explain that, your Honor; prior to 1931 they operated a regular bus line which stopped at some principal cities between Oakland, San Jose and Santa Cruz. Commencing in 1931 the company commenced to operate a local bus service with a 20-minute headway in the metropolitan East Bay area, which means from Oakland, Fruitvale, San Leandro and Hayward. Prior to that time the buses had stopped at Hayward and San Leandro and Oakland, but there was no intermediate service between those points, which is about 15 miles which at the time was built up pretty well along the highway that the buses traveled, but there were some intervening fields and places where new subdivisions were about to be opened.

The company's theory was that in 1931 the bus service could not pay its way, and that they could put on a service which could pay its way by operating buses at infrequent intervals. The company decided to put on a service which [26] would be sufficient to attract new settlers in those communities, and to build up a valuable right. So they went to the Railroad Commission, which is the regulatory body in this state for all public utilities, received a permissive right to operate this local bus line. It was not technically a franchise. It did not convey an exclusive right to that territory, but merely a permissive right to engage in automotive transport along a designated set of streets and highways.

In 1931 on this new development the——

The Member: (Interposing): It was a necessary permit before they could operate, and to that extent was a franchise?

Mr. Sherwood: I merely wanted to explain it was a franchise which was transferable or which was not exclusive. It was a permission to this company.

The Member: Without which they could not operate?

Mr. Sherwood: Without which they could not operate.

The Member: And I suppose by the same token, competitors might have had the opportunity and privilege to engage in the same operations?

Mr. Sherwood: And in fact, they did so. At the end of this period in 1935 this was done. I will explain that in just a moment.

In 1931 on this new development the company traveled 282,127 miles in addition to the routes which they had traversed before, and their revenues were \$48,356.91. [27]

In 1932 they traveled about 40-or 50,000 miles more, and their revenues were about \$10,000 more.

By 1933 they traveled 342,513 miles, and they practically broke even. The operation showed a loss of about \$500.00 for that period.

So that is what we call the first development. I am trying to make this clear because we have two separate developments involved in this procedure over five years.

So then the company went back to the Railroad Commission and got another permit to extend the bus lines to take in some rural towns, small towns with considerable pasture land and truck gardening, and so on, in between, outside the metropolitan area entirely, and these lines went to Alvarado and Castro Valley and way points.

At the proper time I will introduce a little map which shows the exact amounts of these developments.

The mileage then jumped up in 1934 from 342,513 in '33 to 753,697 miles in '34 and 839,046 miles in '35.

All these figures that I have given you are in addition to the regular run which they had operated between San Jose and Santa Cruz, and which they continue to operate to this day, and which is not involved in this controversy at all.

This new development in 1935 got the revenues up to \$108,550.72 and, we will show, showed a loss in the year 1935 on that mileage of \$52,885.41. [28]

In 1936 a competing line on a portion of this route bought out that portion of the Peerless Stages route which is covered by the two developments which I referred to as the "new developments," and they still retain their old original primary business.

The only controversy is over the disposition of that purchase price. The Commissioner has held that the losses sustained from '31 to '35 inclusive were ordinary business losses and deductible in the

years where sustained. The company contend that the money that was spent for the actual rendering of service on these routes was rendered deliberately, knowing that it would not pay in the particular years, but that it would develop a valuable route in the future, and we will show that actually when they sold out, the sales price was almost \$100,000 more than the amount that we are attempting to capitalize as the cost of this development. In other words, they spent \$119,705.58, which we have set up as the cost of developing this route which is arrived at by taking the losses for 1931, 1932, 1933, 1934 and 1935 on those particular routes.

The Member: There were no losses deducted in those years? The losses that you incurred were not deducted?

Mr. Sherwood: In some of them. The taxpayers in filing their returns for the first years, 1931, '32, '33, and '34 did deduct those losses. In 1935 when the largest loss [29] occurred, they did not deduct the losses, but showed them as a capital investment on their 1935 income tax return, and by the way, the Internal Revenue agent then audited those returns and approved them for 1935. Whereupon the company filed amended returns for 1931, 1932, 1933 and 1934 and paid to the Collector of Internal Revenue the additional tax that was due for all those years, except in one in which I believe there was nothing due, computed upon the basis of taking those losses which had been deducted out of the category of

losses and capitalizing them as capital investments. In other words, they increased their net gains for those years by those respective amounts. So that we do not have a completely clear picture either way. They did take the gains in the first instance for the first four years; then filed amended returns and canceled them out. And in 1935 the original return set up the \$52,000 as a capital investment.

There is one point——

The Member: (Interposing): Now, that is all closed; is it?

Mr. Sherwood: Yes.

The Member: As to 1931, for example?

Mr. Sherwood: What?

The Member: 1931, '2, '3, and '4, those years are closed; are they not?

Mr. Sherwood: The Government has the money for those [30] particular years. In order to protect the taxpayer from the possibility of the Commissioner's ruling being sustained here, claims for refund were filed with the proper authorities, and by an agreement being held in abeyance by the Commissioner pending the outcome of this litigation. So that in any event, the Government will get all the tax to which it would have been entitled either way the case is decided.

The Member: But those years are not closed? That is my question. None of those years is closed?

Mr. Sherwood: I meant that they were not involved in this case, but they are pending with the agent's office and he has allowed the refund claims

conditional upon this case being a loss. Of course, if this case is won by the petitioner, the refund claims will be denied.

The Member: He has allowed them, but he has not paid the money?

Mr. Sherwood: That's it. There is one item which might confuse your Honor in listening to the testimony which I think I should clear up in my opening statement.

There was a loss sustained of \$52,885.41 in 1935. When the purchaser of this line made the agreement to purchase in 1936, the agreement to purchase was signed in January in 1936, and in accordance with that agreement, the purchaser set up a price of \$189,000-odd, and then agreed to pay \$30,000-odd to compensate this company for its losses for a portion of its [31] losses sustained in operation in 1935. The bookkeeper of the company took this \$30,000 and set it up on the company's books as a credit against that capital investment of \$52,000 in 1935, but he also set it up as income for 1935. The investigating agent ruled that that was income for 1935, and I agree with him. I cannot see any way out of that, and I think that the agent's ruling was proper.

However, our petition alleges that the total capitalization for the five years was \$119,755. In other words, we are still contending on exactly the same figures, and the only difference is that we are just saying that that \$30,000-credit which was put on

the books by the bookkeeper was in error and should not be considered. It will have no effect upon the tax liability whatsoever because they did pay the tax on it in 1935.

So that the result will be, if the Court rules in this case, that the whole \$52,000 was a capital investment. They have already paid their 1935 tax on that particular item, and when they got that \$30,000 back in 1936 it would not be taxable. So that it simply simplifies the issue to the point where the only point before your Honor now is whether these five losses sustained in operation during those five years in developing these new routes are ordinary business losses or are investments which the petitioner was bound to capitalize. [32]

The Member: What did the petitioner sell in 1936?

Mr. Sherwood: He got permission from the Railroad Commission to assign that permissive right that he had to use those routes and his goodwill and the routes themselves. There were a few buses sold, which are not part of this purchase price. The purchase price was——

The Member (Interposing): There isn't any physical property in question here at all?

Mr. Sherwood: Not in this petition. The agreement segregated those, and the purchaser paid so much for some buses which the agent has passed and which is not involved here. Whatever problems of depreciation there may have been on the buses

was settled by the examining agent, and as far as I know, there is no controversy involving any taxable property in this case at all.

The Member: Now, what do you understand is the controversy in fact, if any? What factual controversy is there? Is there any dispute, for example, as to how much in each year the petitioner sustained as a loss, whether the \$119,000 is, in fact, the correct aggregate of the five years' losses; how much it got; what the comparative figures of what it got and what it paid are? Are any of those in controversy?

Mr. Sherwood: I have here a transcript from the books showing profit and loss statements for every year involved, and a summary. [33]

Now, I can show those to counsel, and if they are in accordance with the revenue agent's report, I suppose we will have no further controversy about them.

The Member: Well, I was just wondering whether the pleadings put all of those questions in issue, or whether they are admitted.

Mr. Sherwood: I think it would be very helpful in developing our written argument, your Honor, in any event, whether the pleadings meet them or not, to have the tables in evidence. I don't want to take a lot of your Honor's time, but I would like to have them in the record.

Some of the arguments based on the Houston Gas Company case are bound up in the figures, the way they are arrived at. I think there will be no

controversy as to the amounts involved here.

I will give counsel a copy of them and offer them when the witness is on the stand, if that is agreeable with your Honor.

The Member: Is that the end of your statement?

Mr. Sherwood: That is my statement, your Honor.

STATEMENT OF CASE ON BEHALF OF THE RESPONDENT.

Mr. Mather: If your Honor please, the petitioner in this case in 1936, in January, 1936, entered into agreement to dispose of its properties, including buses, franchise, and go out of business to a competing concern in the East [34] Bay for the contract, bill of sale provided what would take place, what was to be disposed of, and what price was to be paid.

I do not think there is any question with respect to the amount that was to be paid, what was disposed of.

The date is very important in this proceeding for this reason: Prior to the sale of these properties and prior to the filing of any returns, the petitioner had since 1931 and since its existence taken deductions of ordinary and necessary expenses as operating losses in its return, and it did in 1931, 1932, 1933 and 1934, but the sale being in January of 1936 when the return for 1935 was filed, apparently development expense occurred to the petitioner for

the first time. So amended returns were filed. The return for '35 set up development expense which was nothing but ordinary and necessary business expense of operation of that type of business, and filed amended returns for 1931, '2, '3 and '4 claiming a part of its ordinary and necessary business expense for operating this type of business as the development expense, and in filing its return for '36 claimed deduction of those expenditures which, for the first time in '36—excluding '35—and the return was filed in March of '36, the sale having occurred in January of '36—set up the development expense in the five returns for the first time.

Now, it is our position, if your Honor please——

[35]

The Member (Interposing): Well, there isn't any dispute about the date; is there?

Mr. Mather: The date of sale?

The Member: You said the date is very important. You simply mean that it is important. You do not mean there is an important controversy about that?

Mr. Mather: No. There is no dispute. It is a matter of record. There is a bill of sale——

The Member (Interposing): I misunderstood what you were intending to say.

Mr. Sherwood: I believe there is a copy of the contract of sale attached to our petition.

Mr. Mather: That is correct. Now, it is the position of the respondent that this petitioner acquired a franchise and was operating a transporta-

tion service prior to the incorporation, if you please, of this petitioner. And then the petitioner was incorporated in 1932 and continued to operate under that franchise—well, under the franchise from that time on.

Now, in 1931 it made additional stops in Oakland to pick up passengers, which it had a right to do under the original franchise. Nothing happened in 1931. They decided that there was some customers that they could pick up and make some money. So they made additional stops in '31 as they were permitted to do under their franchise. [36]

Now, in 1934 for the first time the corporation obtained a franchise to deviate from its direct route on East 14th Street and to alternate buses from Oakland through San Leandro via San Lorenzo to Hayward and from Oakland through some other places, and its expenses were the ordinary and necessary expenses of operating that service.

The Member: Make your case.

Mr. Sherwood: Mr. Weiser.

GEORGE J. WEISER

a witness on behalf of petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Sherwood) What is your name, please?

A. George J. Weiser, W-e-i-s-e-r.

Q. Where do you live? A. Oakland.

(Testimony of George J. Weiser.)

Q. Are you connected with the petitioner in this matter? A. I am.

Q. Will you state your official capacity, please?

A. I am secretary and auditor.

Q. When did you first become auditor for the petitioner? A. During 1923.

Q. When did you first become secretary?

A. During 1924.

Q. Have you been continuously both auditor and secretary [38] since 1924? A. I have.

Q. In general, what do your duties comprise?

A. I supervise the accounting of the organization. I handle the duties as secretary of the corporation, and in addition to that, I assist the president and general manager.

Q. What type of work do you do in assisting the president and general manager in addition to accounting work?

A. Occasional discussion of company policy with regard to operating problems.

Q. Who prepares the files, tax returns, for the company? A. I do.

Q. Have you, continuously during all the period from 1924? A. I have.

Q. Approximately when did this company first engage in the transportation business?

A. This company was incorporated in 1923. Prior to 1923 the operations of this company were conducted by several individuals who were operating as an association. I believe these individuals

(Testimony of George J. Weiser.)

engaged in business as early as 1915 or '16.

Q. From the date of incorporation on can you state what the route was that was traversed by the buses of this company?

A. The principal routes of this company consisted of inter-city operation between Oakland and San Jose, San Jose and [38] Santa Cruz, and between Oakland and Palo Alto.

Q. Did any change in the business of the company occur at the end of 1931 in regard to the service rendered?

A. Well, there were changes during 1931 that were instituted.

Q. You have in your hand a little map. Will you state what it is.

A. This map is entitled "Map of Bus Routes between Oakland and Hayward—Years 1931 to 1935, Inclusive."

Mr. Sherwood: Is there any objection to offering the map in evidence as an illustrative exhibit?

Mr. Mather: None whatever for that purpose.

Mr. Sherwood: I have several copies of it, your Honor. Possibly it will be convenient for you to have one in your hand (handing document to the Member).

I will offer this original, then, as the first exhibit.

The Member: That is received.

The Clerk: Exhibit 1.

(The said map so offered was received in evidence, and marked Petitioner's Exhibit No. 1 and made a part of this record.)

MAP OF BUS ROUTES

BETWEEN OAKLAND AND HAYWARD

YEARS 1931 TO 1935 INCLUSIVE.

U S BOARD OF TAX APPEALS
DIV. 10 RECEIVED 100436
ADMITTED TO EXHIBIT

OCT 10 1940

PETITIONER'S

EXHIBIT

RECEIVED



LEGEND

— Development undertaken along E. 14th St. route commencing 1931.

- - - Development undertaken through Castro Valley and San Lorenzo areas commencing 1934.

OAKLAND - HAYWARD DIVISION DATA

Year	Miles	Passenger & Express Receipts
1931	282,127	\$ 48,356.91
1932	328,860	58,230.04
1933	342,513	63,339.08
1934	753,967	101,840.22
1935	939,046	106,680.72



(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, will you state what the route development in red on this map indicates?

A. The route development outlined in red, or, the route outlined in red indicates the development undertaken in the year 1931 between Oakland and Hayward. [39]

Q. Had the company's buses traversed that route before?

A. Yes, they had, as part of an inter-city service from Oakland to San Jose.

Q. Now, will you state specifically what changes in service were made in 1931 along the route which is depicted in red on the map?

A. Well, just prior to 1931 the company made a survey of the area, or the territory surrounding San Leandro and Hayward and realized that here was an area that was ripe for development. It consisted of a great deal of open land or orchard land and tomato land. Climatic conditions in the area were ideal, and it occurred to the company that inasmuch as lots and homesites could be purchased here for very small amounts, and in view of the fact that the area was so close to the city of Oakland, that this territory should really develop into quite a homesite area. And we found that the principal thing that kept development from occurring in this suburban area was the lack of adequate transportation facilities. In order for the area to develop we felt that it was necessary to make available a

(Testimony of George J. Weiser.)

fast and frequent and economical service between Oakland and Hayward so that anyone who might want to settle in the territory would be able to get to their work conveniently, and so that members of their families could get into Oakland for shopping, schools, and other business matters. [40]

We, of course, were very anxious to bring about this development in the shortest possible time, and we had the alternative of proceeding under two plans. The area at that time was very sparsely settled, and we could have put on a skeleton service in the area that we felt would have about broken even or sustained a slight loss. We felt that under this procedure the development of the area would not materialize nearly as rapidly as it would if we put into effect a service which was considerably in advance of the needs of the people who were then living in the area, feeling that that frequency of service would hasten the settlement of the community, attract additional people there in a much shorter period of time.

And so in 1931 we put on a purely local service between Oakland and Hayward, that is, buses originated in Hayward and terminated—or, originated in Oakland and terminated in Hayward.

Q. May I interrupt to ask you: Were these separate buses from the ones you were using on the through route?

A. The inter-city buses continued operation

(Testimony of George J. Weiser.)

through San Jose by way of San Leandro and Hayward, and this service was distinctly an additional, new service for the area. The previous service was merely a casual service on inter-city buses, whereas these were local cars operating between Oakland and Hayward only. [41]

Q. Ah what frequency did they operate?

A. We established a 20-minute frequency in that area in 1931.

Q. At what points would these buses stop on this local run?

A. They would stop at all corners for pickup and all corners for discharge of passengers.

Q. I interrupted you. Is there anything further about the additional development here that you have not told us?

A. Not so far as the year 1931 is concerned.

Q. In the lower right-hand corner of the map there are some statistics as to the miles traveled and the receipts for the particular years.

Were those figures compiled by you?

A. They were.

Q. Did they come from the books of the company?

A. They did.

Q. And are they correct?

A. I believe them to be.

Q. Did the business develop along this route to the point where the development was paying its own way?

(Testimony of George J. Weiser.)

A. Yes. This statistical table on this map of bus routes shows that in 1931 there were 282,000 miles of service rendered by the local buses between Oakland and Hayward and our receipts during the first year of development were \$48,356.91. During the next year, 1932, there was some [42] increase in mileage, that figure going to 328,860, and our receipts improved over the first year of development, the 1932 receipts amounting to \$58,230.04.

In 1933 these receipts improved further to \$63,355.05, and of course the mileage had increased likewise to 342,513.

I might state that right on the heels of the institution of this local service, development or settlement of the area proceeded quite rapidly. It seemed to be the lack of suitable transportation heretofore. That seemed to be the one thing which had held the community back.

Q. Can you state what the actual operating loss was in the year 1933?

A. In the year 1933 the actual loss sustained on the Oakland-Hayward local line was \$516.47, whereas during the first year of development, 1931, the loss was \$15,613.54.

Q. Now, referring to the route which is traced in green upon the map, will you state what that indicates?

A. Well, that indicates the San Lorenzo and Castro Valley area that was serviced commencing with 1934.

(Testimony of George J. Weiser.)

I should like to explain that a little further, if I may.

Q. Just a moment. I will ask you a general question on that. Will you state the steps taken by the company to obtain permission for that extension and what the company did pursuant to that permission? [43]

A. Well, during the latter part of 1933 we checked this area in detail further, and we found that the area immediately north and south of our East 14th Street route was likewise in the same position as the East 14th Street route, that is, we had an ideal setup there for settlement of the community. But the difficulty again was lack of suitable transportation.

Q. I might interrupt you to ask you if there was a decided difference in the intensity of the population between this area and the first one developed.

A. During what—comparing them in what periods?

Q. Let me withdraw that. I don't think the question in intelligible.

Was the population more sparse in this area, that covered by the development shown by the green line, than it had been in the area covered by the first development in 1931?

A. I think generally they were somewhat the same. I don't exactly recall. Both areas were sparsely settled at the time the development com-

(Testimony of George J. Weiser.)

menced, but during 1934 the development along the East 14th Street route, the settlement along the East 14th Street route was considerably more than it was in these outlying territories of San Lorenzo and Castro Valley in which service had not as yet been instituted.

During the latter part of 1933 we filed application with the State Railroad Commission for authority to serve the San Lorenzo and Castro Valley areas. That authority was granted [44] to us, and in 1934 we instituted an additional local service between Oakland and Hayward by way of Castro Valley and San Lorenzo. This likewise operated on an approximate 20-minute frequency, and this service was coordinated with the existing local service along the East 14th Street route, and over all it gave effect to about a 10-minute headway between Oakland and Hayward.

Q. If I understand you then, it gave a 20-minute headway on the new territories covered, but the fact that the same buses went back through East 14th to Oakland reduced the headway on that street to about 10 minutes?

A. On parts of East 14th Street in the area lying between the east city limits of Hayward and A Street in Hayward, which is shown on the map here, and between San Leandro and Oakland the coordination of this service provided a 10-minute frequency. However, to the people who were along the East 14th Street route lying between San Le-

(Testimony of George J. Weiser.)

andro and A Street in Hayward, they only had this 20-minute frequency available, and the other 20-minute frequency was available to the Castro Valley and San Leandro residents.

Q. Can you state the losses sustained in the operation of the development in 1934 and 1935?

A. As to the losses in the operation in 1934, \$39,459.22. And the 1935 loss was \$52,885.41.

Q. Mr. Weiser, I asked you to prepare from your records a [45] statement of profit and loss for the petitioner for the years 1931 to 1935, inclusive. Have you that statement?

A. I have.

Q. You have also a summary page showing the losses for all five years?

A. All five years, so far as they apply to the Oakland-Hayward operation.

Mr. Sherwood: Your Honor, I have here the profit and loss statement of the company for each of the years in question, together with the summary which—except insofar as these controversies, as these issues are in controversy that I outlined—agrees with the Revenue Agent's report. And I would like to have them admitted as exhibit next in order.

Mr. Mather: May I ask your witness a couple of questions?

Mr. Sherwood: Yes, certainly.

(Testimony of George J. Weiser.)

Voir Dire Examination

Q. (By Mr. Mather) Do these documents to which Mr. Sherwood refers, rather, are they substantially the same as shown on your income tax returns for those years? A. They are.

Q. And you had these prepared from the books?

A. They were prepared from the books of our company.

Mr. Mather: Subject to check, if your Honor please, I have no objection. [46]

The Member: Very well. They may be received.

Mr. Sherwood: I am offering the profit and loss statement for the year 1931.

The Clerk: Exhibit 2.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 2 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 2

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1931

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenues.....	\$237,416.87	\$ 47,665.36
Express Revenue.....	8,736.93	691.55
Other Transportation Revenues		
Special Trips.....	15,569.04	
Concession & Check stand.....	5,669.78	
Commissions, etc.	3,585.83	
Total Transportation Revenues.....	\$270,978.46	\$ 48,356.91
Transportation Expenses		
Conducting Transportation		
Drivers wages.....	\$ 44,304.01	\$ 11,733.91
Gasoline.....	25,987.40	6,218.53
Oil.....	2,507.52	608.60
Service Car Expenses.....	77.51	18.35
Station Salaries.....	10,756.32	2,090.40
Station Expenses.....	9,033.05	934.63
Damaged Baggage.....	1.25	—
Shop Expenses.....	19,535.96	5,435.29
Misc. Transportation Expense.....	4,119.83	207.63
Total Conducting Transp.....	\$116,322.85	\$ 27,247.34
Maintenance		
Equipment.....	\$ 41,189.39	\$ 9,826.77
Depreciation.....	57,596.65	13,749.28
Total Maintenance.....	\$ 98,786.04	\$ 23,576.05
Traffic		
Superintendence.....	\$ 5,844.34	\$ 1,435.04
Advertising.....	3,824.98	858.96
Misc. Traffic Expense.....	18.50	4.51
Total Traffic.....	\$ 9,687.82	\$ 2,298.51
General Miscellaneous		
Sals. & Exp. General Officers.....	\$ 11,257.16	\$ 2,688.09
Sals. & Exp. Gen. Office Clerks.....	6,636.11	1,585.68
Office Supplies & Expenses.....	1,862.08	445.13
Stationery & Printing.....	3,741.75	977.93
Insurance Cost.....	10,616.49	2,517.19
Injuries & Damages.....	17,029.50	3,449.67
Legal Expense.....	1,750.80	432.67
Taxes & Licenses.....	11,502.65	2,071.23
Misc. Gen'l. Expense.....	5,770.12	95.88
Total General & Misc.....	\$ 70,166.66	\$ 14,263.47
Total Transportation Expenses.....	\$294,963.37	\$ 67,385.37
Net Operating Loss.....	\$ 23,984.92*	\$ 19,028.46*
[94]		
Page 2		
Net Operating Loss (Forward).....	\$ 23,984.92*	\$ 19,028.46*
Non-Operating Income		
Other Income.....	5,205.71	
Net Income.....	\$ 18,779.21*	
Non-Operating Expenses		
Other Interest.....	\$ 3,612.32	
Misc. Income Charges.....	3,689.19	
Total Non-Oper. Expenses.....	7,301.51	
Net Loss per Books.....	\$ 28,080.72*	\$ 19,028.46*
Adjustments for Income Tax Purposes		
Self Insurance Charges.....	\$ 14,307.53	\$ 3,414.92
Add. 1930 Inc. Tax Adjustment.....	4.95	—
Adjusted Net Loss.....	\$ 11,768.24*	\$ 15,613.54*

*Loss.

[Endorsed]: Petitioner's Exhibit No. 2. Admitted
in evidence Oct. 10, 1940. [95]

(Testimony of George J. Weiser)

Mr. Sherwood: The profit and loss statement for 1932.

The Clerk: Exhibit 3.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 3 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 3

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1932

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenues	\$216,968.30	\$ 57,513.24
Express Revenue	7,311.92	716.80
Other Transportation Revenues		
Special Trips	11,825.45	
Concession & Check Stand	5,125.44	
Commission, etc.	3,185.85	
Total Transportation Revenues	\$244,416.96	\$ 58,230.04
Transportation Expenses		
Conducting Transportation		
Drivers Wages	\$ 37,452.15	\$ 11,063.47
Gasoline	37,335.73	10,529.81
Oil	2,409.97	662.37
Service Car Expense	60.72	17.10
Station Salaries	9,738.00	2,369.68
Station Expenses	8,080.26	917.14
Damaged Baggage	18.75	—
Shop Expenses	14,147.18	4,007.17
Misc. Transp. Exp.	3,567.88	157.34
Total Conducting Transportation	\$112,830.64	\$ 29,724.08
Maintenance		
Equipment	\$ 28,496.24	\$ 8,049.42
Depreciation	59,625.11	16,757.50
Total Maintenance	\$ 88,121.35	\$ 24,806.92
Traffic		
Superintendence	\$ 3,783.95	\$ 1,089.68
Advertising	2,173.24	550.49
Misc. Traffic Expense	36.95	10.47
Total Traffic	\$ 5,994.14	\$ 1,650.64
General Miscellaneous		
Sals. & Exp. Gen'l. Officers	\$ 10,440.94	\$ 2,934.77
Sals. & Exp. Gen'l. Office Clerks	5,691.52	1,590.07
Office Supplies & Exp.	1,482.95	415.86
Stationery & Printing	3,923.62	1,184.57
Insurance Cost	7,647.30	2,141.64
Injuries & Damages	17,000.29	4,735.40
Legal Expense	1,642.31	477.46
Taxes & Licenses	10,269.83	2,491.34
Misc. Gen'l. Expense	4,934.65	39.83
Total General & Misc.	\$ 63,033.41	\$ 16,010.94
Total Transportation Expenses	\$269,379.54	\$ 72,192.58
Net Operating Loss	\$ 25,562.58*	\$ 13,962.54*
[96]		
Page 2		
	Total All Divisions	Oakland-Hayward Division
Net Operating Loss (Forward)	\$ 25,562.58*	\$ 13,962.54*
Non-Operating Income		
Other Income	3,515.12	
Net Income	\$ 22,047.46*	
Non-Operating Expenses		
Other Interest	\$ 5,791.24	
Misc. Income Charges	1,509.87	
Total Non-Oper. Expenses	7,301.11	
Net Loss per Books	\$ 29,348.57*	\$ 13,962.54*
Adjustments for Income Tax Purposes		
Self Insurance Charges	9,715.46	2,731.60
Adjusted Net Loss	\$ 19,633.11*	\$ 11,230.94*
*Loss.		

[Endorsed]: Petitioner's Exhibit 3. Admitted in evidence Oct. 10, 1940. [97]

(Testimony of George J. Weiser.)

Mr. Sherwood: 1933.

The Clerk: Exhibit 4.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 4 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 4

Peerless Stages, Inc.
STATEMENT OF PROFIT AND LOSS FOR YEAR 1933

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenue	\$208,427.18	\$ 62,788.75
Express Revenue	5,656.27	566.80
Other Transportation Revenues		
Special Trips	12,315.23	
Commissions, etc.	1,697.68	
Total Transp. Revenues	\$228,096.36	\$ 63,355.05
Transportation Expenses		
Conducting Transportation	\$ 35,944.91	\$ 11,524.90
Drivers Wages	38,308.99	11,715.33
Gasoline	817.37	256.63
Oil	23.91	7.27
Service Car Expenses	8,616.15	2,216.17
Station Salaries	7,171.10	845.83
Station Expenses	12,578.66	3,889.78
Shop Expenses	2,684.17	146.35
Misc. Transp. Exp.....	\$106,145.26	
Total Conducting Transp.		\$ 30,602.26
Maintenance		
Equipment	\$ 23,234.87	\$ 7,038.65
Depreciation	54,961.40	16,768.72
Total Maintenance	\$ 78,196.27	\$ 23,807.37
Traffic		
Superintendence	\$ 3,431.37	\$ 1,084.63
Advertising	3,678.96	1,189.72
Misc. Traffic Expense	67.80	22.40
Total Traffic	\$ 7,179.13	\$ 2,296.75
General Miscellaneous		
Sals. & Exp. General Officers.....	\$ 9,598.62	\$ 2,915.64
Sals. & Exp. Gen. Office Clerks	4,732.32	1,451.57
Office Supplies & Exp.	1,233.56	382.29
Stationery & Printing	2,994.80	950.93
Insurance Cost	4,469.11	1,325.62
Injuries & Damages	15,272.91	4,628.59
Legal Expense	1,240.91	372.81
Taxes & Licenses	9,800.71	2,740.26
Misc. Gen'l. Exp.	255.34	83.60
Total General Expense	\$ 49,598.28	\$ 14,851.31
Total Transportation Expenses	\$241,118.94	\$ 71,557.69
Net Operating Loss	\$ 13,022.58*	\$ 8,202.64*

[98]

Page 2

	Total All Divisions	Oakland-Hayward Division
Net Operating Loss (Forward)	\$ 13,022.58*	\$ 8,202.64*
Non-Operating Income		
Other Income	62,003.82	
Net Income	\$ 48,981.24	
Non-Operating Expenses		
Other Interest	\$ 4,092.75	
Misc. Income Chgs.....	2,456.78	
Total Non-Oper. Expenses	6,549.53	
Net Profit per Books	\$ 42,431.71	\$ 8,202.64*
Adjustments for Income Tax Purposes		
Add: Self Insurance Charges	\$ 6,124.74	\$ 1,873.01
Depreciation Adjustment	19,009.05	5,813.16
Totals	\$ 67,565.50	\$ 516.47*
Less: Transfer of Insur. Reserves	50,344.52	
Adjusted Net Profit	\$ 17,220.98	\$ 516.47*

*Loss.

[Endorsed]: Petitioner's Exhibit 4. Admitted in
evidence Oct. 10, 1941 [99]

(Testimony of George J. Weiser.)

Mr. Sherwood. 1934.

The Clerk: Exhibit 5.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 5 and made a part of this record.)

(Testimony of George J. Weiser.)

PETITIONER'S EXHIBIT NO. 5

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1934

Page 1

	Total All Divisions	Oakland-Hayward Division
Operating Revenues		
Passenger Revenues	\$255,408.80	\$100,974.22
Charter Trips	18,137.87	
Express Revenue	5,747.89	666.00
Mail Revenue	110.09	
Concession Rental	1,593.99	
Total Operating Revenues	<u>\$280,998.64</u>	<u>\$101,640.22</u>
Operating Expenses		
Maintenance & Garage Expense		
Parts & Outside Repairs	\$ 24,402.01	\$ 12,231.61
Repair Labor	18,937.84	9,430.54
(Greasing, Washing, Storage)	6,532.87	3,083.51
Tire Cost	9,644.53	4,716.52
Garage Super.—Sals. & Exp.	2,836.31	1,446.73
Light, Heat, Water, Power	1,237.23	624.24
Misc. Shop Exp.	3,843.77	1,979.02
Total Maintenance & Garage Exp.	<u>\$ 67,434.56</u>	<u>\$ 33,512.17</u>
Transportation Expenses		
Super. of Transp.—Sals. & Exp.	\$ 2,715.75	\$ 1,392.89
Drivers Wages & Bonuses	51,440.20	24,121.84
Gasoline—Busses	39,124.49	19,100.93
Oil—Busses	677.42	341.54
Bus Supplies	653.69	304.20
Other Transp. Exp.	642.28	305.11
Total Transp. Exp.	<u>\$ 95,253.83</u>	<u>\$ 45,566.51</u>
Station Expense		
Company Stations—Sals.	\$ 6,464.75	\$ 3,242.11
Company Stations—Other Exp.	848.55	406.02
Comm. Station Expense	1,124.77	568.81
Total Station Expense	<u>\$ 8,438.07</u>	<u>\$ 4,216.94</u>
Traffic Promotion & Adv.		
Salaries & Expenses	\$ 3,788.66	\$ 1,901.30
Tkts.—Baggage Chks., etc.	1,355.76	664.87
Tariffs & Schedules	845.64	431.74
Advertising	1,250.75	597.32
Total Traffic Promotion & Adv.	<u>\$ 7,240.81</u>	<u>\$ 3,595.23</u>
Insurance & Safety Exp.		
Workmen's Compensation	\$ 1,043.23	\$ 504.39
Public Liab. & Prop'ty. Damage	21,090.80	10,328.18
Fire & Theft Insurance	1,109.27	530.60
General Insurance	4,130.94	2,001.21
Total Ins. & Safety Exp.	<u>\$ 27,374.24</u>	<u>\$ 13,364.38</u>
Carried Forward	<u>\$205,741.51</u>	<u>\$100,255.23</u>

[100]

Peerless Stages, Inc.
STATEMENT OF PROFIT AND LOSS FOR YEAR 1934

Page 2

	Total All Divisions	Oakland-Hayward Division
Operating Expenses (Brought Forward).....	\$205,741.51	\$100,255.23
Administration Expenses		
Gen'l. Officers Sals. & Exp.	\$ 9,774.74	\$ 4,413.74
Gen'l. Office Clerks Sals. & Exp.	6,371.50	3,105.32
Stationery, Prtg. & Supplies	2,566.34	1,233.19
Misc. Gen'l. Office Exp.	340.82	166.08
Telephone & Telegraph	1,407.41	683.78
General Legal Expense	1,953.92	960.55
Misc. Expense	777.94	370.82
Total Admin. Expenses	\$ 23,192.67	\$ 10,933.48
Total Operating Expense	\$228,934.18	\$111,188.71
Operating Taxes, Rents & Depr.		
Operating Taxes		
Gasoline Taxes	\$ 12,340.18	\$ 6,042.66
Public Utility Taxes	12,019.96	4,330.78
Other Licenses	25.00	12.75
Real Estate Taxes	6.27	3.25
Federal Capital Stock Taxes	150.00	77.55
Federal Excise Taxes	5,211.76	2,542.16
Total Operating Taxes	\$ 29,753.17	\$ 13,009.15
Operating Rents		
Shop Rents	\$ 2,700.00	\$ 1,308.60
Terminals & Stations	292.50	142.44
Office Rents	780.00	378.01
Joint Facilities Rents	4,200.00	2,035.60
Total Operating Rents	\$ 7,972.50	\$ 3,864.65
Depreciation & Retirements		
Depreciation of Busses	\$ 50,652.67	\$ 24,613.03
Depreciation Other Property	5,441.59	2,618.67
Total Depr. & Retirements	\$ 56,094.26	\$ 27,231.70
Total Oper. Taxes, Rents & Depr.	93,819.93	44,105.50
Total Operating Costs	\$322,754.11	\$155,294.21
Net Operating Loss	\$ 41,755.47*	\$ 53,653.99*
Other Income		
Non Operating Prop'ty. Rentals	\$ 952.00	
Profit or Loss from Disposal of Ppty.	175.00	
Total Other Income	1,127.00	
Other Deductions		
Misc. Inc. Chgs.	\$ 12.36	
Interest Paid	3,410.93	
Non-Oper. Prop'ty. Taxes, Exp.	1,112.54	
Total Other Deductions	4,535.83	
Net Loss per Books	\$ 45,164.30*	\$ 53,653.99*
Net Loss per Books (Forward)		
Adjustments for Income Tax Purposes	\$ 45,164.30*	\$ 53,653.99*
Self Insurance Charges	\$ 7,327.09	\$ 3,581.48
Depreciation Adjustment	20,646.81	10,613.29
Miscellaneous	167.00	
Adjusted Net Loss	\$ 17,023.40*	\$ 39,459.22*

*Loss.

[Endorsed]: Petitioner's Exhibit No. 5. Admitted
in evidence Oct. 15, 1940. [102]

(Testimony of George J. Weiser.)

Mr. Sherwood: 1935.

The Clerk: Exhibit 6.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 6 and made a part of this record.) [47]

(Testimony of George J. Weiser.)

PETITIONER'S EXHIBIT NO. 6

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1935

Page 1

	Total All Divisions	Oakland-Hayward Division
Operating Revenues		
Passenger Revenues	\$269,953.24	\$107,763.07
Charter Trip Revenues	16,138.55	
Express Revenue	5,984.35	787.65
Misc. Comm., Etc.	1,378.41	
Concession Rentals	360.00	
Total Operating Revenues	\$293,814.55	\$108,550.72
Operating Expenses		
Maintenance & Garage Expense		
Parts & Outside Repairs	\$ 21,563.02	\$ 11,082.79
Repair Labor	18,611.31	9,565.70
Greasing, Washing & Storage	7,339.21	3,772.15
Tire Cost	12,685.73	6,520.11
Garage Super.—Sals. & Exp.	3,385.39	1,740.00
Light, Heat, Water & Power	1,373.86	706.13
Misc. Shop Exp.	3,697.97	1,900.65
Total Maintenance & Gar. Exp.	\$ 68,656.49	\$ 35,287.53
Transportation Expenses		
Super. Transp. Sals. & Exp.	\$ 3,300.00	\$ 1,696.11
Drivers Wages & Bonuses	55,874.68	28,718.04
Gasoline—Busses	35,446.88	18,218.71
Oil—Busses	1,696.48	871.94
Bus Supplies	313.79	161.28
Other Transp. Exp.	957.87	492.32
Total Transp. Exp.	\$ 97,589.70	\$ 50,158.40
Station Expense		
Company Stations—Sals.	\$ 6,777.51	\$ 3,483.45
Company Stations—Other Exp.	902.71	463.97
Commission Station Exp.	1,310.51	673.57
Total Station Exp.	\$ 8,990.73	\$ 4,620.99
Traffic Promotion & Adv.		
Salaries—Expense	\$ 4,991.17	\$ 2,565.32
Tickets, Baggage Checks, etc.	2,106.39	1,082.63
Tariffs & Schedules	527.46	271.10
Advertising	1,128.35	579.94
Total Traffic Promotion & Adv.	\$ 8,753.37	\$ 4,498.99
Insurance & Safety Exp.		
Workmen's Compensation	\$ 1,009.15	\$ 518.68
Public Liab. & Prop'ty, Damage	24,148.00	12,411.40
Fire & Theft Insurance	802.81	412.62
General Insurance	4,297.44	2,208.77
Total Ins. & Safety Exp.	\$ 30,257.40	\$ 15,551.47
Carried Forward	\$214,247.69	\$110,117.38

(Testimony of George J. Weiser.)

Mr. Sherwood: And this summary page of the exhibits.

The Clerk: Exhibit 7.

(The said summary so offered and received in evidence was marked Petitioner's Exhibit No. 7 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 7

SUMMARY OF OAKLAND-HAYWARD DIVISION DEVELOPMENT LOSSES

Years 1931 to 1935 Inclusive

Year	Amount
1931	\$ 15,613.54
1932	11,230.94
1933	516.47
1934	39,459.22
1935	52,885.41
Total Development Losses.....	<u>\$119,705.58</u>

[Endorsed]: Petitioner's Exhibit No. 7. Admitted in evidence Oct. 10, 1940. [106]

Direct Examination (resumed)

Q. (By Mr. Sherwood) Mr. Weiser, these figures which you have set forth in Exhibit 7, which is the summary sheet—pardon me. I took yours away from you. This is Exhibit 7 (handing document to the witness).

Do you not include any items of loss sustained by the operation of the inter-city service from Oakland to San Jose, Santa Cruz and Palo Alto?

(Testimony of George J. Weiser.)

Mr. Mather: Now, if your Honor please, I will have to object to that as leading.

Mr. Sherwood: It is leading, your Honor. I will be glad to reframe it.

The Member: Reframe the question.

Q. (By Mr. Sherwood) I will just ask you, Mr. Weiser, what portion of the company's operations was covered by the summary sheet which is Exhibit 7, which purports to show losses.

A. The Oakland-Hayward operation only.

Q. And does it include anything other than that local operation? [48]

A. It does not.

Mr. Sherwood: It will be stipulated, Mr. Mather, that the copy of the agreement of sale between the petitioner and the Railway Equipment and Realty Company, Ltd., which is annexed to the petition on file, is a true and correct copy of that agreement and may be in evidence as such?

Mr. Mather: Well, apparently, Mr. Sherwood, that was not admitted in the answer, and I have never seen the agreement. Do you have the agreement here?

Mr. Sherwood: It was my understanding that this exhibit is in here because it was included in the Revenue Agent's report itself.

Mr. Mather: Well——

Mr. Sherwood (Interposing): As an exhibit to the report. Pardon me.

Q. (By Mr. Sherwood) Have you the original with you, Mr. Weiser?

A. I don't believe I have the original with me.

(Testimony of George J. Weiser.)

Q. You are familiar with the exhibit here?

A. That is correct.

Q. And it was prepared under your direction; was it not? A. The exhibit?

Q. Yes, on your petition.

A. You have reference to the contract between—
—I did not prepare that. [49]

Q. You have read it and are familiar with it?

A. I have read it and was one of the parties that signed it.

Mr. Mather; Just show him a copy.

Q. (By Mr. Sherwood) I will show you a copy of what purports to be the contract which is annexed to the petition, and ask you to look at it and ask you if that is the agreement that was signed.

The Member: Suppose you take the original and let him identify that?

Mr. Sherwood: Yes, your Honor.

Q. (By Mr. Sherwood) Look at this copy. That was annexed to the petition on file with the Board.

A. (Examining documents.)

The Member: You say that that is a correct copy of the agreement?

The Witness: Yes.

Mr. Sherwood: It is stipulated, then, that the copy attached to the petition may be admitted into evidence as a correct copy of the original?

Mr. Mather: That is agreeable, your Honor.

The Member: Very well.

Mr. Sherwood: Excuse me a moment while I check my file (examining document).

(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, did you prepare the [50] income tax returns and amended returns for the petitioner during the years from 1931 to 1935, inclusive? A. I did.

Q. And what action did you take in regard to the losses shown on Exhibit 7 for the years 1931 to 1934, inclusive?

A. The losses sustained were deducted as ordinary losses for the years 1931 to 1934, inclusive, in the original returns.

Q. What was done in 1935?

A. In 1935 our tax return was filed whereby we capitalized the loss, development loss, on the Oakland-Hayward local division.

Q. Was that return ever audited by a representative of the Internal Agent in charge at San Francisco? A. Yes, it was.

Q. Did you receive any communication from the Internal Revenue agent in charge relative to the report? A. I did.

Q. Was the return accepted as filed?

Mr. Mather: That is objected to as calling for a conclusion of the witness.

The Member: Sustained.

Mr. Sherwood: I will come back to that, your Honor, in just a moment when I have the letter.

Q. (By Mr. Sherwood) What further proceeding was had [51] regarding the returns for 1931 to 1934?

(Testimony of George J. Weiser.)

A. I prepared amended returns for the years 1931 to 1934, inclusive, in which these development losses were capitalized.

Q. Did you make any entries in your books showing the capitalization of your losses in the aggregate sum of \$119,835.41?

A. \$119,705.58 is the figure, and those items were entered on our records at the time that the amended returns were filed.

Q. Can you state—

The Member (Interposing): Well, do I understand from that that the answer is “yes” to the question that was put?

The Witness: Yes, with the exception of the amount—correction as to the amount.

Mr. Sherwood: As to the amount, the witness corrected it.

Q. (By Mr. Sherwood) Can you state the reason why the original returns took these amounts as losses, and the amended returns were filed, showing them as capital investments?

A. I filed the returns for the years 1931, '32, '33, and '4 without any special thought or discussion of the matter with anyone; just indicated them as ordinary expenses and deducted them as such.

However, as the possibility of sale was being discussed [52] in our organization in the very late part of 1935, some of our directors felt that there was going to be quite a tax problem involved and felt that I should secure advice in connection with it,

(Testimony of George J. Weiser.)

whereupon I consulted a few accountants and reviewed the situation with them, and they advised me that it was their opinion that I had filed my 1931, 1932, '3 and '4 returns in correctly; that I had included extraordinary expenses as ordinary expenses. And they suggested that I file amended returns, and likewise for the year 1935 I filed my return on the basis whereby the item of loss on the Oakland-Hayward operation was capitalized.

Q. Did the officials of the company at the time the new development was contemplated in 1931——

The Member (Interposing): Now, don't make this leading. I sense a leading question before you ask it. You had better reframe it.

Mr. Sherwood: I am going to try to avoid that, your Honor.

The Member: "Did they do so and so" usually calls for a "yes" or a "no" answer, and it is an easy way to suggest to the witness what you want him to say.

Mr. Sherwood: I was going to ask, your Honor, if they discussed——

The Member (Interposing): You will commit the same fault if you talk about it. The thing I want to do is get [53] this witness' own fresh testimony and not this suggested testimony.

Mr. Sherwood: I think, your Honor, I can ask the question without indicating the answer I want, but it necessarily will have to call for a "yes" or "no" answer, I believe, to start with.

(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, was there any discussion or conversations held by the officials of the company about the time the company was investigating the possibility of opening up this new route, regarding whether the route would be immediately profitable or not?

A. Yes, there was discussion.

Q. Now, would you state the gist of the conclusions expressed by the officials?

Mr. Mather: That is objected to, unless the question is made more specific, who talked to whom, and what the conversations were.

This is a corporation, and I think that the conversations that you are discussing, names and dates and places are important.

The Member: I will sustain the objection.

Mr. Sherwood: I will attempt to comply with counsel's suggestion, your Honor.

Q. (By Mr. Sherwood) May I ask: How many directors does the company have?

A. The company has five directors. [54]

Q. How many people own any substantial amount of stock in the company?

A. Four of those directors.

Q. Four of the same five directors?

A. That is correct.

Q. Will you state the names of these people?

A. J. B. Held, S. H. Dunbar, D-u-n-b-a-r, B. A. Perry, P-e-r-r-y, H. D. Gaeta, G-a-e-t-a—you just wanted the stockholders?

(Testimony of George J. Weiser.)

Q. Do those four people you have mentioned own substantially all of the stock of this company?

A. They own all of the stock of the company.

Q. They own all of it. And they are four of the five directors?

A. That is correct.

Q. Who is the fifth director?

A. I am.

Q. And these four gentlemen are the men you referred to a while ago as being the original operators before they incorporated the business in one business?

A. That is correct.

Q. Did you five directors hold any meetings, either formal or informal wherein the matter of the proposed extension of bus service between Hayward and Oakland was discussed?

A. Yes, many of them. [55]

Q. Will you state with as much particularity as you can where those meetings were held and the approximate times?

A. No, it would be extremely difficult for me to do, Mr. Sherwood, because there were so many of these meetings of an informal type. Our organization is not large. It is a small organization. And we are all actively engaged in the business, and we see each other many times during the course of the day. And these things are apt to come up for discussion at most any time, and they did.

Q. But can you definitely recall that there were meetings at about the time this development was undertaken, in which the matters of the development were discussed?

(Testimony of George J. Weiser.)

A. Yes, I can recall that there were meetings.

Q. Well, now, going back to the question that I asked a while ago, was the matter of the possible realization of immediate profit from the new operation discussed at these informal meetings?

A. It was.

Q. Can you state the gist of the discussions?

A. We realized that we would have to perform this service at a loss for several years if we undertook the settlement program in the manner in which we did undertake it.

Q. Were any alternative manners discussed?

A. Yes.

Q. Will you state what they were? [56-57]

A. I believe I made mention of that earlier, and that is the installation of a skeleton service, one that would give service to those who were then residing in the territory. It would of necessity be a very skimpy service without a great deal of frequency.

Q. Was that discussed as an alternative to some other plan? A. (Pause)

Q. Mr. Weiser, when you mentioned those matters a while ago, you said the company felt—what I am trying to do is get testimony as to whether the individual said so-and-so, not what they felt. I understand the reason you are hesitating is that you think you have already covered this matter but I would like to have in the record as to what happened, but not as to what some indefinite individual said.

(Testimony of George J. Weiser.)

A. It was the unanimous consensus of opinion of the directors that of the two plans of development before them, one the so-called "skeleton service," the other the "extra frequency service," the opinion of the Board was that the extra frequency service would produce development of the area in a much faster period of time with quicker and greater ultimate profit to the company after development had occurred than would the skeleton plan, and it was therefore decided to institute the extra-frequency service method of development.

Q. Can you state whether or not the matter of actual loss [58] was discussed?

A. Yes, it was discussed.

Q. What was said about that?

Mr. Mather: That is objected to unless the time, place, and date is fixed.

The Member: We will take a recess for five minutes.

(Whereupon a brief recess was taken, after which proceedings were resumed, as follows:)

Mr. Sherwood: You may cross examine.

Cross Examination

Q. (By Mr. Mather) Mr. Weiser, under what authority were operations carried on prior to 1931?

A. Under a certificate of public convenience and necessity granted by the State Railroad Commission.

Q. Was there any different authority granted in 1931?

A. There was not.

(Testimony of George J. Weiser.)

Q. And the service that you rendered between Oakland and Hayward in 1931 was carried on under the same franchise that had been granted prior to that date?

A. Under the same certificate, yes.

Q. Yes. When did you get a new certificate or an additional certificate?

A. During the latter part of 1933.

Q. Was it issued prior to 1934?

A. I believe it was. [59]

Q. Do you know——

A. (Interposing) Or, I don't have the exact date with me. But it was either the latter part of 1933 or the very early part of 1934.

Q. Now, what did that provide for?

A. That provided authority for us to serve the San Lorenzo and Castro Valley areas which are shown on this map in green.

Q. Yes. And also a direct route on East 14th Street?

A. That is correct.

Q. Now, what do you mean by "skimpy service"?

A. That is a little bit difficult to answer, but maybe I can illustrate it in this way: Where there is a sparse settlement in the community, or in a community, there may exist a need at that time for those living in the community for a bus or two during working hours in the morning, and then possibly returning those people at night to their homes from their work, with the possible addition of an

(Testimony of George J. Weiser.)

occasional schedule during the day for shopping purposes, and particularly by "skimpy," I meant a service that would show little or no loss, or possibly a small profit.

Q. Well——

A. (Interposing) Of course it would be designed to only render a service for those who were then living in the community.

Q. By "skimpy service," then, do you mean a service [60] commensurate with the demand occasioned at that time?

A. Commensurate—a service commensurate with the existing needs of the then residents of the territory.

Q. This service that you rendered in '31 between Oakland and Hayward, 20-minute service, was that over the same route that you operated prior to that time? A. That is correct.

Q. And you had been operating a through service on this same route for a number of years?

A. An inter-city service over that route, yes.

Q. In other words, you put on additional buses that went over the same place, a service every 20 minutes?

A. In 1931, '32, and '3; that is correct.

Q. How many additional buses did you put on at that time?

A. I can't answer that without referring to our plant account.

Q. What other services were being rendered by competing companies at that time?

(Testimony of George J. Weiser.)

A. At that time and for a number of years prior thereto there was a street car line in operation between Oakland and Hayward.

Q. And that operated through all these years; did it not? A. Yes.

Q. Now, what increase in population was there in this area in 1931? [61]

A. I can't answer the question specifically, but I know from personal observation that there was an increase in population in the area which we served immediately following the institution of this new local service of Peerless.

Q. And that apparently would be the latter part of 1931; would it not?

A. It followed shortly on the heels—that is, some development commenced immediately upon the institution of the service.

Q. There were subdivisions and building going on in that area prior to '31, was there not?

A. There were some subdivisions in the territory where owners of property were attempting to sell their lots for home development, but were not succeeding particularly well because of the lack of suitable transportation facilities.

Q. What in your opinion was the increase in population from '31 to '36?

A. It would be difficult for me to hazard a guess. I merely know that in this area where heretofore you could see acre after acre of orchard land and tomato land, you now find block after block of homes.

(Testimony of George J. Weiser.)

Q. Referring to Petitioner's Exhibit 2, and to Petitioner's Exhibit 7, Mr. Weiser, I am not entirely clear as to what the \$15,613.54 represents. Will you tell me?

A. The \$15,613.54 represents the losses sustained—or, [62] rather, represents the difference between the amounts expended in operating on the Oakland-Hayward local operation during 1931 and the receipts received from that operation during the year 1931.

Q. Well, now, can you pick those out on Exhibit 2, which I understand to be the total operations?

A. Exhibit 2 covers both the total operations and to the right, the right-hand columns, represent the results of the Oakland-Hayward operation which are included in the figures shown for the total of all divisions.

Q. Well, then, the item, "\$15,613.54" appearing for the year 1931 on Exhibit 7 is simply your ordinary cost of operations of your Hayward-Oakland transportation system, is that not?

A. I wouldn't say they were our ordinary costs. I would say they were the difference between the costs of performing that service and the actual receipts.

Q. Well, does Exhibit 2 show you the expenses in connection with that operation?

A. That is correct.

Q. Pick out for me the extraordinary costs in Petitioner's Exhibit 2.

(Testimony of George J. Weiser.)

A. I feel that all items of expenses shown there when totaled, and to the extent that they exceed the receipts of the operation, are extraordinary expenses. [63]

Q. Well, just pick out the extraordinary expenses in Petitioner's Exhibit 2; enumerate them for me.

A. Well, there are extraordinary expenses included in drivers' wages, gasoline, oil, service car expenses, station salaries, station expenses, shop expenses, miscellaneous transportation expense, and every item of expense that is shown hereon.

Q. All right. Now, take drivers' wages, the item set up there as \$11,733.91. What did that represent?

A. That represented the amounts paid to drivers operating buses on the Oakland-Hayward local operation.

Q. What did those drivers do?

A. Performed all duties required of drivers, which is the operation of the bus, collecting fares from passengers, handling passengers' baggage, and so forth.

Q. All right. Now, wherein did their services differ from the services of your drivers operating on your through service?

A. In a general way, there was no difference so far as the actual service which they perform. However, there was this extra frequency of service.

Q. They had to stop more often?

A. No. I mean by that that there were more

(Testimony of George J. Weiser.)

drivers working on the Oakland-Hayward buses than the immediate needs of the territory. [64]

Q. Well, by that do you mean that you did not have enough customers who were paying fares to warrant the number of drivers that you had?

A. You might put that interpretation on it.

Q. Now, tell me with respect to the gasoline, the extraordinary expense in connection with that.

A. In a general way, the same thing holds true of gasoline as holds true of drivers' wages. These amounts were expended for gassing the buses operating on the Oakland-Hayward local operation.

Q. Is that true for all the items for all the years? A. That is correct.

Q. Well, I am a little confused, Mr. Weiser, about Exhibit 3, the left-hand column of which appears to show the Oakland-Hayward operation.

Now, on Petitioner's Exhibit 7 the loss, I think, is \$11,230.94 for '32, and where does that appear on Exhibit 3?

A. It is the last figure in the right-hand column of Exhibit 3.

Mr. Sherwood: Which page?

The Witness: Of page 2.

Q. (By Mr. Mather) Well, then, that represents net operating loss of some \$13,000 on the Hayward division plus an adjustment for income taxes of \$2,000?

A. That is correct. There are certain items of self-insurance [65] which the Commissioner has not permitted us to deduct.

(Testimony of George J. Weiser.)

Q. Now, with respect to these discussions in connection with the operation of the Hayward-Oakland service, when that was instituted was there any formal action taken by your board of directors?

A. During 19—you are referring to the institution of service in 1931?

Q. That is correct.

A. I feel that there was some formal action taken by the board because it involved the acquiring of additional buses, and I know that that matter is spread on the minutes of the company, the acquisition of additional equipment. And there may be some further explanation as to just why the need for this additional equipment arose, as spread on the minutes.

Q. You testified, I believe, Mr. Weiser, that you prepared the returns of this petitioner for all of the years '31 to and including '36?

A. That is correct.

Q. And also the amended returns that were prepared?

A. That is correct.

Q. And claims for refund were filed. Did you prepare those also, with respect to the amended returns?

A. I either filed the claims for refund myself or caused them to be prepared.

Q. And claims for refund for all of the years in which [66] amended returns were filed have been filed; have they not?

A. (Pause)

Q. From '31 to '35?

(Testimony of George J. Weiser.)

A. With the exception of the year 1932, that is correct. No claim for refund for '32, as my memory serves me, was filed.

Mr. Mather: No further cross examination.

The Member: Have you more from this witness?

Mr. Sherwood: No more, your Honor.

The Member: Stand aside.

(Witness excused.)

Mr. Sherwood: By the way, for the record I would like to correct my opening statement. Your Honor probably has already discovered that I was in error, and Mr. Mather was correct in saying that they did not get two certificates from the Railroad Commission. I said they got one in '31 and one in '34, and I was in error. I thought they had, but the witness says they did not.

The Member: We will suspend now until 2:00 o'clock.

(Thereupon at 12:30 o'clock p. m., a recess was taken until 2:00 o'clock p. m. of the same day.)

[67]

Afternoon Session

2 o'Clock P. M.

(Brief interruption for other matters.)

The Member: Are you still cross examining the witness?

Mr. Mather: No, if your Honor please. I have completed my cross examination.

However, in connection with his testimony, we have agreed that it may be stipulated that the amended returns covering the years 1931, 1932, 1933 and 1934 in which development expense was capitalized were filed with the Collector of Internal Revenue on May 21, 1936.

Mr. Sherwood: We so stipulate, your Honor.

The Member: Am I to understand that that is the only modification appearing in the amended return from what had appeared in the original returns? That is to say, the elimination from the original returns of the deductions of the amounts of ordinary and necessary expenses which are now claimed to have been the amounts which have been capitalized as to these two routes? I want only your stipulation. I don't want testimony.

Mr. Sherwood: What your Honor says is correct with one exception, namely, the year 1933. The examining agent had questioned some items of depreciation, and the taxpayer adjusted those in accordance with the Revenue Agent's request, which resulted in a slightly larger tax for that year than

they had paid in addition to the deduction for this loss being [68] eliminated.

The Member: Well, I take it it appears plainly on the amended return as a modification of the deduction already taken for depreciation?

Mr. Sherwood: Yes.

The Member: So that it shows on the return as being something entirely unrelated to this issue?

Mr. Sherwood: Yes, I believe that is true, and that the Revenue Agent's—the letter of the Revenue Agent, the 90-day letter upon which this petition was filed which incorporates it, shows all of the facts which will be necessary for us to have in evidence here in order for the Board—

The Member (Interposing): I don't care about that. I am only talking about the amended returns that Mr. Mather spoke about that were filed on that stipulated date.

Mr. Sherwood: Yes.

The Member: All right. Your next witness?

Mr. Sherwood: Mr. Howell.

FRANKLIN D. HOWELL

a witness called on behalf of petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Sherwood) Your name, please?

A. Franklin D. Howell, H-o-w-e-l-l.

Q. Where do you live, Mr. Howell? [69]

A. Los Angeles, California.

Mr. Sherwood: The next questions, your Honor, will be directed toward qualifying Mr. Howell as an expert.

Q. (By Mr. Sherwood) What is your profession, Mr. Howell?

A. I am a civil and mining engineer, educated at the University of Pennsylvania.

Q. Will you state what educational institutions you attended?

A. The University of Pennsylvania. I have been in practice in the profession for pretty nearly 55 years.

Q. In connection with the practice of your profession, have you been engaged in any phase of the transportation industry?

A. I have been. Probably fifty per cent of that time has been in the transportation industry, either steam or electric railway, or motor bus operation.

Q. Would you state more precisely what you did in connection with your employment in the transportation industry?

A. In the motor bus industry, or all?

Q. All the transportation industry.

A. Construction, operation, valuations, rate making.

Q. Would you give the years and the place?

A. Over 55 years ago. That is a pretty big order.

Q. Could you summarize them briefly, your principal experiences?

(Testimony of Franklin D. Howell.)

A. Well, I say over 50 per cent of it has been transporta- [70] tion, in the bus business, in the freight business, and the automobile business. I have been engaged in that since 1915 with some little railroad work aside from that, but in 1915 I was appointed chief engineer of the Board of Public Utilities of Los Angeles and was there for four years.

Then in connection with all utilities before the Railroad Commission got jurisdiction over the utilities in the city of Los Angeles, and before there was any regulation on the motor bus industry, which did not come in until 1917; on January 1, 1919 I resigned as chief engineer of the public utilities department and went in with the then White Bus Line as general manager; remained as general manager and vice president until 1933 when the property was sold to the Pacific Electric Railway.

Also in 1919 I was one of the organizers of the Motor Carriers Association of this state; was the first secretary-manager, and later vice president, and for the last eight years up to '33 was its president. That association was organized to promote the business and regulate it and get it on a stable transportation basis. And I had a hand in all the regulatory laws that were drawn, and assisted in their passage.

Q. Have you had occasion to appear before state and federal regulatory bodies?

A. Oh, yes, in rail cases, a number of them, and

(Testimony of Franklin D. Howell.)

in practically [71] all utility, gas and electrical, and in the motor bus industry as well.

Q. What public bodies have you appeared before?

A. The State of California; in one, two instances, before the Federal Courts, and before the Interstate Commerce Commission.

Q. The White Bus Line changed took another name?

A. It changed its name to the Motor Transit Company.

Q. In your employment by the Motor Transit Company, what was the general nature of your duties there?

A. Organization and management of the development of the plant, equipment. There we built all our own cars. In the early days of the business we were using passenger cars, touring cars, and overhauling them, pitching them up to larger capacity. But we were the first company to go into building our own.

Q. While you were president of the Motor Transit Company did you have occasion to develop new bus lines in addition to the lines that were in existence when you first went with the company?

A. Motor Transit Company was built up from one short line, Los Angeles and Whittier, into a service throughout the Counties of Los Angeles, San Diego, San Bernardino and Riverside; all started

(Testimony of Franklin D. Howell.)

from one short line, and the additional lines were either developed directly by the Motor Transit [72] Company, or purchased them.

Q. In terms of mileage, how much of a development was that that you have described?

A. Oh, it was about 50 per cent. It went from about four cars up to some 250 cars equipment. It ran from a few miles up to—when we sold it—up to between five and five and a half million car miles a year.

Q. Is there an accounting practice which is generally recognized in the transportation industry and by the state-federal regulatory bodies concerning the proper allocation between ordinary expenses and capital investments attendant upon the development of new transportation facilities?

Mr. Mather: May I ask if that is still directed toward qualification?

Mr. Sherwood: No. This is the first question, Mr. Mather, I wish to ask of this witness.

The Member: That is what he is supposed to be an expert about.

Mr. Mather: I object to that as irrelevant and immaterial.

The Member: Sustained.

Mr. Mather: I object to that as irrelevant and immaterial.

The Member: Sustained. Do you also include "incompetent" in that?

(Testimony of Franklin D. Howell.)

Mr. Mather: No, sir. [73]

The Member: You don't?

Mr. Mather: I don't, no, sir.

The Member: You have excluded "incompetent"?

Mr. Mather: Yes.

The Member: All right. Go ahead.

Q. (By Mr. Sherwood) In the practice of developing bus lines, Mr. Howell, do newly started bus lines usually pay a profit upon the operation from the time of their inception?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Sustained.

Mr. Sherwood: May we have an exception, your Honor?

The Member: You have an exception to every adverse ruling.

Mr. Sherwood: Thank you, your Honor.

Q. (By Mr. Sherwood) Mr. Howell, in the development of a bus service over a route not previously served, are items such as wages for drivers, gasoline and oil which would normally be part of the operating expense of such an operation be classified as "development costs" under any circumstances?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Sustained.

(Testimony of Franklin D. Howell.)

Mr. Sherwood: In order to save time, may I ask your [74] Honor if the objection is to the form of the question or just the general idea that I couldn't prove these things by an expert?

The Member: Just the general idea that the things you are attempting to prove are irrelevant and immaterial.

Mr. Sherwood: Well, there is no use in taking your Honor's time on this matter.

I would say that I might make a tender of proof, just for the record, that what I desire to show by Mr. Howell, he has reduced to written form and I can state exactly what I would like to prove, that there is a general practice recognized by accountants for transportation companies, public utilities, by public utility accountants, and by the State Railroad Commission and the Federal Interstate Commerce Commission which recognizes the fact that early losses, both by the operation of facilities which are in advance of the needs of the community, are capital investments to the extent, and only to the extent, that the cost of rendering the service exceeds the revenue from that particular division.

Th Member: That is what you are proffering now?

Mr. Sherwood: Yes, your Honor.

The Member: All right. I will reject the proffer.

Mr. Sherwood: No more questions of Mr.

Howell. Thank you, your Honor. We have our exceptions in the record?

The Member: Yes. [75]

(Witness excused.)

Mr. Sherwood: We have no further testimony.

The Member: That is your case?

Mr. Sherwood: That is our case.

The Member: Does the Government have any evidence?

Mr. Mather: No, your Honor.

The Member: Your answer is "no"?

Mr. Mather: The answer is "no."

Mr. Lewis: Could we have 40 days, your Honor, to file briefs?

The Member: I don't think you need reply briefs, do you?

Mr. Lewis: I don't know, of course, what would come out in the brief, but from the general——

The Member (Interposing): Unless I am very much mistaken, you haven't got a Chinaman's chance. I shouldn't think the Government would need to file a brief. It seems to me that it is perfectly clear that you can't do what you are attempting to do. I may be wrong about it, and you may be able to convince me in a brief that I am wrong, and you may have 40 days to file a brief, but I don't see any necessity for additional time.

Therefore, the case will be submitted upon your briefs 40 days hence. [76]

Mr. Sherwood: That is satisfactory.
Hearing Concluded.

[Endorsed]: U. S. B. T. A. Filed Oct. 29, 1940.
[77]

[Title of Board and Cause.]

Docket No. 100436. Promulgated December 19, 1940.

Excess of costs over receipts of the operation of a transportation line deducted on returns for earlier years of operation held not properly included in the basis of gain from disposal of the line in a later year.

Clyde C. Sherwood, Esq., and John V. Lewis, Esq., for the petitioner.

T. M. Mather, Esq., for the respondent.

The Commissioner determined a deficiency of \$25,289.85 in income tax and \$9,609.39 in excess profits tax of petitioner for 1936, refusing to allow the operating losses of prior years to be included in the basis for determining profit realized from a sale.

FINDINGS OF FACT.

Petitioner, a California corporation with its principal office in Oakland, was organized in 1923. It took over from four individuals, who became its only stockholders and who were four of its five directors, the operation of a bus transportation system between Oakland, Palo Alto, San Jose, and

Santa Cruz which the four individuals had been operating under a certificate of the California State Railroad Commission.

The area between Oakland and Hayward contained orchard and tomato lands. For several years before 1931 a street car line had been operated between those points. At that time petitioner had given intermediate bus service as part of its intercity service between Oakland and San Jose. Petitioner considered two alternative plans for providing the area with transportation—one, a skeleton service which would merely take care of the existing demand, and the other, a more frequent service at 20-minute intervals. Petitioner adopted the latter plan and in 1931 established a local service in addition to the intercity service. The busses stopped to take on or discharge passengers at any corner. The area developed rapidly. [78]

In 1933 petitioner filed with the State Railroad Commission an application for authority to extend the local bus service to the Castro Valley and San Lorenzo areas. Authority was granted, and in 1934 the new service was instituted on a 20-minute frequency. This service was coordinated with the existing local service, thereby giving 10-minute service to certain areas.

In 1931-1935 the miles traveled, the passenger and express receipts, and the loss from operation of the new local service, computed by deducting from transportation revenues the transportation expenses,

self-insurance charges, and depreciation adjustments, were as follows:

	Miles	Receipts	Loss
1931	282,127	\$ 48,356.91	\$ 15,613.54
1932	328,860	58,230.04	11,230.94
1933	342,513	63,355.05	516.47
1934	753,967	101,640.22	39,459.22
1935	839,046	108,550.72	52,885.41
Total			\$119,705.58

In 1935 petitioner's directors contemplated abandoning the new local routes to another transportation company, and on January 14, 1936, made such a contract, including the sale of 15 busses. The consideration was \$180,000 plus \$30,000 as reimbursement for petitioner's local service operating deficit from April 1 to December 31, 1935, and a sum equal to petitioner's local service operating deficit from January 1, 1936, to the date of actual abandonment of the local service.

On its income tax returns for 1931-1934, petitioner deducted the losses from operation of the new routes. On May 21, 1936, amended returns were filed for these years, and on them and on the return for 1935 these losses, aggregating \$119,705.58, were treated as having been capitalized.

OPINION

Sternhagen: On its return for 1936 petitioner reported a capital gain of \$92,334.14, by including in its basis the \$119,705.58 aggregate losses from

the operation of the services from Oakland to Hayward, Castro Valley, and San Lorenzo. These amounts for each year through 1934 had been used by petitioner as deductions in computing its taxable income, either as operating expenses or losses. The Commissioner increased the gain from the transaction in 1936 by excluding the \$119,705.58 from the basis, saying "there is no authority under the provisions of section 113 (b), Revenue Act of 1936, to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive." Petitioner contends that the general excess of operating expenses over operating receipts from the new routes were capital expenditures not properly deductible in the year of operation.

The Commissioner's determination is correct. So far as the evidence shows, the losses in question were entirely operating expenses and petitioner properly took deductions for them in the respective years of operation. The fact that the new operation resulted in greater expenses than receipts is not alone reason to capitalize them. Had there been expenditures which could be identified as not attributable to current operation but directly and clearly to capital, there might be some ground for permitting or even requiring a taxpayer to omit them from current deductions and charging them to "capital account" as contemplated by section 113 (b) (1) (A). This has been held in respect of the cost of solicitation of new business and of free serv-

ice given to build good will. *Houston Natural Gas Corporation v. Commissioner*, 90 Fed. (2d) 814; cf. *News Publishing Co. v. Blair*, 29 Fed. (2d) 955; *Successful Farming Publishing Co. v. Commissioner*, 64 Fed. (2d) 890. But nothing in the evidence would have supported such treatment in the years of expenditure, and nothing supports such treatment in the later year when the business was discontinued. The excessive cost of current operation would not be regarded as invested capital for the purpose of measuring excess profits under the earlier statutes.

Decision will be entered for the respondent. [80]

United States Board of Tax Appeals
Washington

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

In accordance with the Board's report, promulgated December 19, 1940, it is

Ordered and Decided that there are deficiencies

for 1936 of \$25,289.85 in income tax and \$9,609.39 in excess profits tax.

Enter:

Entered Dec. 20, 1940.

(s) J. M. STERNHAGEN,

Member. [81]

[Title of Board and Cause.]

PETITION FOR REVIEW BY THE UNITED
STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Now comes the petitioner, Peerless Stages, Inc.,
and respectfully shows:

I.

Jurisdiction

The petitioner on review, hereinafter referred to as the taxpayer, is a California corporation. Said taxpayer filed a federal income-tax return for the calendar year 1936 with the Collector of Internal Revenue for the First District of California, located in the City of San Francisco, State of California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The respondent on review is the duly appointed, [82] qualified, and acting Commissioner of Internal Revenue of the United States, hereinafter referred

to as the Commissioner, holding his office by virtue of the laws of the United States.

II.

Nature of Controversy

The taxpayer is a California corporation organized in 1923, which operated a bus transportation system between Oakland, Palo Alto, San Jose, and Santa Cruz under a certificate of the California State Railroad Commission.

The area between Oakland and Hayward contained much undeveloped acreage. In 1931 the directors of taxpayer considered providing the area with transportation, realizing that inasmuch as the taxpayer performed no service locally within the City of Oakland, it was dependent upon such territory if it wished to develop its operative right. A survey was made upon which it was found that there was available in this area an abundance of homesites, ideal from the point of view of climatic conditions and price; and it was also found that unless frequent, economical transportation service was provided for commuters, shoppers, students, and those attending business, the settlement of such area would be greatly retarded.

The directors of taxpayer considered two alternative plans for providing the area with transportation: one, a skeleton service which would merely take care of the existing demand; and the other, a more frequent service at [83] twenty-minute intervals. The latter plan was adopted in 1931, the di-

rectors of the taxpayer believing that such service would develop the territory, which in turn would develop an operative right of great value. Patronage gradually increased during the years 1931, 1932, and 1933, at which time the receipts of the operation had been brought to a point that almost equaled the annual expense of the operation, and the development phase of that operative right was about completed.

In 1933, however, taxpayer filed an application with the California State Railroad Commission for authority to extend the local bus transportation service to the Castro Valley and San Lorenzo areas, which areas, as in the former case, were sparsely settled because of the lack of suitable transportation facilities.

In 1934, upon authority being granted, the new service was instituted on a twenty-minute frequency. This service was coordinated with the existing local service, thereby giving ten-minute service to certain areas. The cost of this extra frequency of service over and above immediate needs was not incurred for immediate benefit, but was a definite cost incurred for the benefit of future years.

In 1931-1935 the miles traveled, the passenger and express receipts, and the loss from operation of the new local service, computed by deducting from the transportation revenues the transportation expenses, self-insurance charges, and depreciation adjustments, were as follows: [84]

	Miles	Receipts	Loss
1931	282,127	\$ 48,356.91	\$ 15,613.54
1932	328,860	58,230.04	11,230.94
1933	342,513	63,355.05	516.47
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1935	839,046	108,550.72	52,885.41
Total			\$119,705.58

Railway Equipment and Realty Company, Ltd., applied for and received a permit to operate transportation facilities over the same territory. On January 14, 1936 the taxpayer sold out its local routes to its competitors. Certain equipment was sold for a specific price, and in addition the Railway Equipment and Realty Company, Ltd., agreed to pay the taxpayer to abandon its local routes to it. The consideration was \$180,000 plus \$30,000 as reimbursement for taxpayer's local service operating deficit from April 1 to December 31, 1935, and a sum equal to taxpayer's local service operating deficit from January 1, 1936 to the date of actual abandonment of the service.

Under the aforesaid contract the taxpayer reported as taxable income in its corporation and excess-profits tax return for the calendar year 1936 a capital gain of \$92,334.74, which amount represented the profit made on the abandonment of the operative rights. In its accounting records for the calendar year 1935 the taxpayer capitalized the sum of \$119,705.58, representing the cost of development of the operative rights. Amended income-tax

returns for the calendar years 1931 and [85] 1932, and amended income and excess-profits tax returns for the calendar year 1934 were filed with the Collector of Internal Revenue, San Francisco, California, on May 18, 1936. On them and on the income-tax return for 1935, these losses were treated as having been capitalized. The return for 1935 was accepted as correct after a field examination and audit by the Internal Revenue Agent in Charge, San Francisco.

The United States Board of Tax Appeals approved the Commissioner's redetermination of excluding the \$119,705.58 from the basis, and thereby increasing the gain from the transaction in 1936, on the thesis that there was no authority under the provisions of section 113(b), Revenue Act of 1936, to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive. The contention of the taxpayer is that this determination is in error and that the annual deficit of operation of the new bus lines as capitalized represented the cost of development of the operative rights and should not be treated as expenses deductible solely in the year of operation.

III.

ASSIGNMENT OF ERRORS

The taxpayer avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and final decision rendered and entered by the United States Board of

Tax Appeals, manifest error occurred and [86] intervened to the prejudice of the taxpayer, which now assigns the following errors and each of them, which it avers occurred in said record, proceedings, opinion and final decision so rendered by the United States Board of Tax Appeals:

1. In determining the taxable net income of the taxpayer for the calendar year 1936 the Board of Tax Appeals erroneously affirmed the action of the Commissioner in increasing the income \$119,705.58.

2. Error was committed by the Board of Tax Appeals in failing to allow the taxpayer a cost basis of \$119,705.58 for the developed operative rights, which rights the taxpayer agreed to abandon to the Railway Equipment and Realty Company, Ltd., under its contract with that company.

3. Error was committed in the determination that under the Revenue Act of 1936, the taxpayer had no authority to capitalize the cost of development of the operative rights.

4. Error was committed in holding that the expenditures were attributable to current operation and not to capital when such expenditures were made directly and in contemplation of creating a valuable and developed operative right.

5. Error was made in rejecting the proffer of evidence to show that there is a general practice recognized by accountants for transportation companies and public utilities, by the California State Railroad Commission and by the United States Interstate Commerce Commission, which establishes

that early losses, caused by the operation of facilities [87] which are in advance of the needs of the community and to build the community, are capital expenditures to the extent that the cost of rendering the service exceeds the revenue.

Wherefore, taxpayer respectfully petitions that the decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to end the errors complained of by review of said Court.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery Street,

San Francisco, California. [88]

State of California,

City and County of San Francisco—ss.

Clyde C. Sherwood, being duly sworn, says: I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information, and belief. This petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

CLYDE C. SHERWOOD

Subscribed and sworn to before me this 6th day of March, 1941.

[Notarial Seal] LOUIS WIENER,
Notary Public in and for the City and County of
San Francisco, State of California.

[Endorsed]: U. S. B. T. A. Filed March 11, 1941.

[89]

[Title of Board and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Commissioner of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

J. P. Wenchel, Attorney for Respondent,
Chief Counsel, Bureau of Internal Revenue,
Internal Revenue Building, Washington,
D. C.

You Are Hereby Notified that on the 11th day of March, 1941, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above-entitled cause, was filed with the Clerk of the Board. A copy of the petition as filed is attached hereto and served upon you.

Dated: March 6th, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery Street,

San Francisco, California. [90]

Service of the foregoing notice of filing and of a copy of the petition for review is hereby acknowledged this 11th day of March, 1941.

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue,

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 16, 1941.

[91]

[Title of Board and Cause.]

STIPULATION THAT EXHIBITS SHALL BE INCLUDED IN RECORD ON APPEAL.

It Is Hereby Stipulated by and between Peerless Stages, Inc., petitioner, by and through its attorneys Clyde C. Sherwood and John V. Lewis; and the Commissioner of Internal Revenue, respondent, by and through his attorney J. P. Wenchel, that the Clerk of the United States Board of Tax Appeals shall include in the record on appeal with the transcript of the evidence prepared by the stenographic reporter, the exhibits which were admitted in evidence in the above-entitled matter.

Dated: July 22nd, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery St.,

San Francisco.

J. P. WENCHEL,

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 26, 1941.

[92]

[Title of Board and Cause.]

DESIGNATION OF THE PORTIONS OF THE
RECORD, PROCEEDINGS, AND EVIDENCE
TO BE CONTAINED IN THE
RECORD ON APPEAL.

To: The Clerk of the United States Board of Tax Appeals, Internal Revenue Building, Washington, D. C.;

To: The Commissioner of Internal Revenue and to J. P. Wenchel, Attorney for Respondent, Chief Counsel, Bureau of Internal Revenue, Internal Revenue Building, Washington, D. C.

You and Each of You Are Hereby Notified that the petitioner above named hereby designates the portions of the record, proceedings, and evidence to be contained in the record on appeal as follows, to-wit:

1. The docket entries.

2. The petition to the Board of Tax Appeals.
3. The answer of the Commissioner.
4. The entire transcript of the evidence prepared by the stenographic reporter. [107]
5. The findings of fact, opinion, and decision of the Board of Tax Appeals.
6. The petition for review by the United States Circuit Court of Appeals for the Ninth Circuit and the assignment of errors therein contained.
7. Notice of filing petition for review and assignment of error.
8. This notice designating the portions of the record, proceedings, and evidence to be contained in the record on review.

Dated at San Francisco, California, July 11th, 1941.

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
Attorneys for Petitioner,
333 Montgomery St.,
San Francisco, California.

Service of the foregoing Designation of the Portions of the Record, Proceedings, and Evidence to be Contained in the Record on Appeal, is hereby acknowledged this 17th day of July, 1941.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 17, 1941.

[108]

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 108, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 2nd day of August, 1941.

[Seal]

B. D. GAMBLE,

Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 9891. United States Circuit Court of Appeals for the Ninth Circuit. Peerless Stages, Inc., a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed August 9, 1941.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
For the Ninth Circuit

No. 9891

PEERLESS STAGES, INC.,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF FACTS UPON WHICH AP-
PELLANT INTENDS TO RELY AND
DESIGNATION OF RECORD TO BE
PRINTED.

To the Clerk of the United States Circuit Court of
Appeals for the Ninth Circuit; and

To Samuel O. Clark, Jr., Assistant United States
Attorney General; and J. P. Wenchel, Esq.,
Chief Counsel, Bureau of Internal Revenue:

You and Each of You Are Hereby Notified that
appellant hereby adopts as its statement of points
upon which appellant intends to rely on appeal, the
assignment of errors contained in appellant's peti-
tion for review by the United States Circuit Court
of Appeals for the Ninth Circuit. Appellant hereby
designates for printing the entire transcript of pro-
ceedings before the United States Board of Tax
Appeals.

Dated: August 11th, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Appellant,
333 Montgomery Street,
San Francisco, California.

AFFIDAVIT OF SERVICE BY MAIL

[C. C. P. 1013A]

State of California,

City and County of San Francisco—ss.

Margaret Moore, being sworn, says that she is a citizen of the United States, over 18 years of age, a resident of Alameda County, and not a party to the within action.

That affiant's residence (business) address is 5631 Florence Avenue, Oakland, California.

That affiant served copies of the attached statement of facts upon which appellant intends to rely and designation of record to be printed by placing said copies in an envelope addressed to Samuel O. Clark, Jr., Assistant United States Attorney General, at his office (residence) address, Justice Building, Washington, D. C.; and in an envelope addressed to J. P. Wenchel, Esq., Chief Counsel, Bureau of Internal Revenue, at his office address, Internal Revenue Building, Washington, D. C., which envelopes were then sealed and postage fully prepaid thereon, and thereafter were on August 11,

1941 deposited in the United States mail at San Francisco, California.

That there is delivery service by United States mail at the place so addressed, or regular communication by United States mail between the place of mailing and the place so addressed.

MARGARET MOORE

Subscribed and sworn to before me on August 11th, 1941.

[Seal] LOUIS WIENER,

Notary Public in and for said County
and state.

[Endorsed]: Filed Aug. 12, 1941. Paul P.
O'Brien, Clerk.

No. 9891

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

PEERLESS STAGES, INC.,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the
United States Board of Tax Appeals.

PETITIONER'S OPENING BRIEF.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

333 Montgomery Street, San Francisco,

Attorneys for Petitioner.

FILED

OCT - 6 1941

PAUL F. O'BRIEN,

CLERK



Subject Index

	Page
Jurisdiction of the Court.....	1
Statement of the Case.....	2
Specification of Errors	7
Argument	8
I. Petitioner contends that a motor-bus company should treat as a capital investment, instead of ordinary business losses, actual operating loss incurred in extending its service to new territory, where such service is known to exceed the immediate requirements of the communities served and where such service is undertaken with the knowledge in advance that it will operate at a loss for a considerable period of time but where such service is expected to foster the development of the new territory covered and thereby develop a profitable bus route in a shorter period of time than would have been the case if an infrequent service had been instituted at a possible profit.....	8
Conclusion	17

Table of Authorities Cited

Cases	Pages
Decker v. Welch, 15 A.F.T.R. 1027.....	15
Hill, et al. v. Antigo Water Co., 3 Wis. Ry. Comm. Rep., 623	14
Houston Electric Company v. City of Houston, 265 Fed. 360	14
Houston Natural Gas Corporation v. Commissioner of Internal Revenue, 90 Fed. (2d) 814, 19 A.F.T.R. 932...8, 10, 13	
Lafayette Telephone Co., re (Indiana Public Service Com- mission), P.U.R. 1920 A 422.....	13
Liberty Insurance Bank v. Commissioner of Internal Reve- nue, 14 B.T.A. 1428.....	11
Meredith Publishing Company v. Commissioner of Internal Revenue, 64 Fed. (2d) 890, 12 A.F.T.R. 467.....	11, 12
Northwestern Yeast Co., Appeal of, 5 B.T.A. 232.....	11
Richmond Hosiery Mills v. Commissioner of Internal Revenue, 6 B.T.A. 1247, aff'd 29 Fed. (2d) 262.....	11
S. C. Toof & Co. v. Commissioner of Internal Revenue, 21 B.T.A. 916	15
United Profit-Sharing Corporation v. United States, 66 Ct. Cl. 171, 6 A.F.T.R. 7850.....	16

Codes

Internal Revenue Code, Section 1141, paragraphs (a) and (b)	2
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No. 9891

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

PEERLESS STAGES, INC.,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the
United States Board of Tax Appeals.

PETITIONER'S OPENING BRIEF.

JURISDICTION OF THE COURT.

This is a petition to review a decision of the United States Board of Tax Appeals. The petitioner on review is a California corporation and filed its income-tax return for the calendar year 1936 with the Collector of Internal Revenue for the First District of California at San Francisco, California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit. The respondent on review is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States.

The case arose because the Commissioner claimed a deficiency of income tax for the year 1936 in the sum of \$25,289.85 and a deficiency in excess-profits taxes for the same year in the sum of \$9,609.39. The case regularly came up for hearing before the United States Board of Tax Appeals at San Francisco, California, on October 10th, 1940. Upon the 19th day of December, 1940, the said United States Board of Tax Appeals made its findings of fact and opinion and rendered its decision in favor of the respondent for the full amount of the alleged deficiencies. On the 11th day of March, 1941, and within the time allowed by law therefor, petitioner filed its petition for review by the United States Circuit Court of Appeals, Ninth Circuit, with its assignment of errors.

This Court has jurisdiction upon appeal to review the decision of the United States Board of Tax Appeals in question by virtue of the provisions of paragraphs (a) and (b) of Section 1141 of the Internal Revenue Code.

STATEMENT OF THE CASE.

During the period from 1923 to 1930, inclusive, petitioner operated a motor-bus service between various cities in Northern California (Tr. 42). One of the petitioner's lines ran from Oakland to San Jose, traveling along a thoroughfare known as East Fourteenth Street through the cities of Oakland, San Leandro, and Hayward. The bus line afforded an intercity service but did not offer a purely local passenger service (Tr. 45). The area between Hay-

ward and Oakland contained a good deal of orchard and garden land which was suitable by location and climatic condition for homesites but which had not been developed chiefly because of a lack of an adequate transportation system (Tr. 45).

The petitioner decided to make available a fast, frequent, and economical service between Oakland and Hayward, so that any one who might want to settle in the territory could get to work conveniently, and members of his family could go into Metropolitan Oakland for shopping, schools, and other purposes (Tr. 46).

In planning the extension of petitioner's bus route, its board of directors considered two plans (Tr. 46, 76). One is referred to as the "skeleton service." This would have consisted of running just enough busses to take care of the existing passenger demand and would have resulted in little or no loss to the company. The other plan is referred to as the "extra frequency service." Petitioner's board of directors discussed the feasibility of both plans and decided that the extra frequency service would produce development of the new territory in a faster period of time with a greater ultimate profit, and the board was willing to incur an actual operating loss in the earlier stages of the development in order to accomplish this result (Tr. 75).

Those in charge of the management of the petitioner realized that because of the sparsely settled neighborhood a complete, frequent service could not pay the cost of operating until the neighborhood should develop. It was feasible to offer a local service of a

skeleton nature which could operate without loss. However, the company felt that by installing a service that would be in advance of the actual needs of the persons then living in the area, the settlement of the community would be hastened and additional customers would be attracted to the neighborhood (Tr. 76).

In 1931 the company inaugurated a local service; that is, busses originated or terminated in Hayward and Oakland. This operation was entirely separate and distinct from the previous intercity operation. Different busses were used and were run at a twenty-minute frequency. The busses would stop at all corners to pick up and discharge passengers (Tr. 46, 47).

The belief of the officials of the company that the operation of a frequent service at a loss would soon result in the development of new business was justified by the records of the years 1931, 1932, and 1933. The petitioner's records show the following figures for the new route (Tr. 48):

Year	Miles Traveled	Passenger and Express Receipts	Loss from Operation
1931	282,127	\$48,356.91	\$15,613.54
1932	328,860	58,230.04	11,230.94
1933	342,513	63,355.05	516.47

(Tr. 53, 56, 58; Exhibits 2, 3, 4.)

It appears without contradiction from the record that development and settlement of the area served proceeded very rapidly after the institution of the local bus service (Tr. 48).

In 1933 the company made a survey of adjacent territory which might likewise be developed for local

bus service. San Lorenzo and adjacent territory lay to the south of East Fourteenth Street, while Castro Valley and adjacent territory lay to the north of East Fourteenth Street. During the latter part of 1933, petitioner filed an application with the California State Railroad Commission for authority to extend its local bus service to the San Lorenzo and the Castro Valley area. A permit was received, and in 1934 petitioner instituted an additional local service between Oakland and Hayward by way of Castro Valley and San Lorenzo. This service was likewise operated on a twenty-minute frequency and was coordinated with the existing local service along the East Fourteenth Street route so that along that route the result was a ten-minute headway between Oakland and Hayward (Tr. 48, 49, 50).

The company's officials expected to sustain a loss in the early operation of this new bus route, but believed that the bus route would develop the territory to such an extent that it would ultimately prove a profitable investment (Tr. 75).

The miles traveled, the passenger and express receipts, and the losses for the years 1934 and 1935 are as follows:

Year	Miles Traveled	Passenger and Express Receipts	Loss from Operation
1934	753,967	\$101,640.22	\$39,459.22
1935	839,046	108,550.72	52,885.41

These figures pertain exclusively to the new routes and have nothing to do with the intercity bus service which the company had been conducting for many years (Tr. 96).

Petitioner's income-tax returns for the years 1931, 1932, 1933, and 1934 deducted the losses sustained from the operations above described as business losses. Mr. George J. Weiser, petitioner's auditor, testified that he prepared and filed the returns for those years without any special thought or discussion of the matter of their being capital investments or ordinary expenses. In the latter part of 1935, the directors of the company were discussing the possibility of a sale of the local bus routes with which we are here concerned. The question of tax liability was discussed, and Mr. Weiser secured expert advice as to the situation. He was advised that in the opinion of these experts, the expenses of development in 1931, 1932, 1933, and 1934 had been incorrectly classified, and they suggested that amended returns be filed (Tr. 71-72). Pursuant to this advice, petitioner filed its return for the year 1935 upon the basis whereby the loss on the local operation was capitalized instead of classified as an ordinary business loss. At the same time, amended returns for the years 1931, 1932, 1933, and 1934 were filed, and the petitioner's tax liability recomputed upon the theory that the sums above stated to be operating losses were capital investments; and additional taxes were paid to and accepted by the Collector of Internal Revenue (Tr. 72).

On January 14, 1936, petitioner entered into a contract of sale with Railway Equipment & Realty Company, Ltd., whereby petitioner sold its local motor-coach lines and operative rights to Railway Equipment & Realty Company, Ltd. The petitioner retained its intercity bus business which it had been

operating prior to the institution of the local bus service. The petitioner reported a gain on the sale of \$92,334.74. The Internal Revenue Agent's report declared the gain on the sale to be \$212,040.32. The difference of \$119,705.58 between the amount reported by the company and the amount found by the Internal Revenue Agent represents the capitalization of the operating losses of petitioner's local routes from 1931 to 1935, inclusive. The facts and figures are not in dispute, and the only question involved is whether petitioner is entitled to capitalize its losses for the five years rather than treat them as ordinary business losses (Tr. 96).

SPECIFICATION OF ERRORS.

The United States Board of Tax Appeals erred in determining the taxable net income of Peerless Stages, Inc., for the calendar year 1931, by failing to allow the taxpayer a cost basis of \$119,705.58 for the developed operative rights agreed to be abandoned in that year to the Railway Equipment and Realty Company, Ltd., the \$119,705.58 being the sum of the losses incurred by taxpayer in developing a new territory in contemplation of creating a valuable and developed operative right by the operation of facilities in advance of the needs of the community, knowing that such losses would be incurred.

ARGUMENT.

- I. PETITIONER CONTENDS THAT A MOTOR-BUS COMPANY SHOULD TREAT AS A CAPITAL INVESTMENT, INSTEAD OF ORDINARY BUSINESS LOSSES, ACTUAL OPERATING LOSS INCURRED IN EXTENDING ITS SERVICE TO NEW TERRITORY, WHERE SUCH SERVICE IS KNOWN TO EXCEED THE IMMEDIATE REQUIREMENTS OF THE COMMUNITIES SERVED AND WHERE SUCH SERVICE IS UNDERTAKEN WITH THE KNOWLEDGE IN ADVANCE THAT IT WILL OPERATE AT A LOSS FOR A CONSIDERABLE PERIOD OF TIME BUT WHERE SUCH SERVICE IS EXPECTED TO FOSTER THE DEVELOPMENT OF THE NEW TERRITORY COVERED AND THEREBY DEVELOP A PROFITABLE BUS ROUTE IN A SHORTER PERIOD OF TIME THAN WOULD HAVE BEEN THE CASE IF AN INFREQUENT SERVICE HAD BEEN INSTITUTED AT A POSSIBLE PROFIT.

The Circuit Court of Appeals, Fourth Circuit, in the case of *Houston Natural Gas Corporation v. Commissioner of Internal Revenue*, 90 Fed. (2d) 814, 19 A.F.T.R. 932, in referring to a public utility entering a comparatively new field where it had not been able to do much business before, said, at p. 817:

“But an intensive campaign to get new customers at any time gives rise to capital expenditures and the time when such expenditures might be incurred is not confined to the early or formative stages of a company * * *”

In the case now before the Court, the petitioner was incorporated in 1923 and engaged in the business of operating a bus line between Oakland, San Jose, and Santa Cruz, California, and between Oakland and Palo Alto, California, until late in 1931 (Tr. 42).

Just prior to 1931 the company prepared a survey of the territory surrounding San Leandro and Hayward and decided to expand their operations by put-

ting in a local bus service between Oakland, San Leandro, and Hayward. The area was largely open land, but climatic conditions were ideal, and it appeared to the company that inasmuch as lots and homesites could be purchased here for a very small amount and were close to the City of Oakland, this territory should develop into quite a homesite area. Development had been hampered by a lack of adequate transportation facilities. The company decided to make available a fast, frequent, and economical service between Oakland and Hayward in order to encourage the development (Tr. 46). A skeleton service would have delayed the development of the area. A high-frequency service was therefore put on in 1931, being entirely distinct from the intercity busses which continued operation to San Jose by way of San Leandro and Hayward and in addition thereto. The new busses ran at a twenty-minute frequency (Tr. 46, 47).

The directors of petitioner at the time they entered into the new local service realized that the twenty-minute-frequency service instead of the skeleton service would have to be operated at a loss for several years (Tr. 73, 74, 70).

During the year 1931, 282,000 miles of service were rendered by the new service of local busses between Oakland and Hayward. The receipts from this service were \$48,356.91. During the year 1932, the mileage was increased by 328,860 miles, and the receipts amounted to \$58,230.04. In 1933, the mileage was increased to 342,513 miles, and the receipts increased to \$63,355.05. This increase in service caused a rapid

development and settlement of the area (Tr. 47, 48). During the first year of development, 1931, the loss from local service was \$15,613.54 (Tr. 48). During the year 1932, the loss from the local service amounted to \$11,230.94. During the year 1933, the actual loss sustained on the new local line between Oakland and Hayward was only \$516.47 (Tr. 96).

During the latter part of 1933 or the early part of 1934, petitioner secured a new certificate authorizing the petitioner to serve the San Lorenzo and Castro Valley areas. The outlying territory of San Lorenzo and Castro Valley was sparsely settled at the time that petitioner instituted local service (Tr. 49, 50). This territory was operated on an approximate twenty-minute frequency. The addition of these busses together with the busses on the Oakland-Hayward development made the East Fourteenth Street to Oakland service on a frequency of about ten minutes (Tr. 50).

The loss in the operation of this frequent service in 1934 was \$39,459.22, and in 1935 the loss was \$52,885.41. As the loss for the Oakland-Hayward local line had been reduced to \$516.47, because of the development of the community after the installation of the service (Tr. 51, 48), a very valuable right and goodwill had been built up on the Oakland-Hayward local route by the end of 1933. These losses were therefore a capital investment and should have been capitalized by the taxpayer.

Houston Natural Gas Corp. v. Commissioner of Internal Revenue, supra, at 816.

The entirely new development which resulted in the losses of 1934 and 1935, known as the San Lorenzo and Castro Valley development, is even more clearly a capital expenditure. This territory had never had any public transportation facilities before the petitioner received its right to enter the territory from the California Railroad Commission and started its development of the territory in 1934 (Tr. 49, 50).

In *Liberty Insurance Bank v. Commissioner of Internal Revenue*, 14 B.T.A. 1428, the Board held that the amounts expended for novelty banks distributed to obtain new depositors were disallowed as a business expense on the ground that the expenditures created benefits extending into future years. The Board said at 1435:

“In several cases we have pointed out that expenditures for advertising and promotion may create or increase the value of an asset in the nature of a trade name or good will. We have pointed out that in such cases it would be proper to capitalize that portion of such expenditures that can properly be said to be directed toward such an object. *Northwestern Yeast Co.*, 5 B.T.A. 232; *Richmond Hosiery Mills*, 6 B.T.A. 1247; *affd.* 29 Fed. (2d) 262. The difficulty is a practical one in determining what portion represents a current expense of the business of the year and what portion is properly to be attributed to future years. We are satisfied that in the instant case the usefulness of these banks as an advertisement for the petitioner did not cease with the taxable year.”

The Circuit Court of Appeals, Eighth Circuit, in the case of *Meredith Publishing Co. v. Commissioner*

of *Internal Revenue*, 64 Fed. (2d) 890, 12 A.F.T.R. 467, held that magazine circulation is an intangible capital asset, and money spent in increasing it is a capital expenditure not deductible as an ordinary business expense in determining the publisher's taxable income. The Court, at p. 893, says:

“ ‘Circulation structure is an asset which must be continually supported by bringing in new subscriptions to replace those which are continually expiring. *Gardner Printing Company Case*, *supra*. The cost of so supporting the circulation structure is an ordinary and necessary business expense but the cost of building up or establishing a circulation structure must be charged to capital.’ ”

In the case before the Court it is clear that on the two new routes on which the losses were capitalized the bus company was not maintaining its present business status but was knowingly going into new territory which was undeveloped and which would necessarily take a long period of time to develop to a paying status. Petitioner contends that it made an expenditure of a large amount of money to acquire something of permanent use or value in its business. The company acquired many new customers as shown by the increase in its receipts. Territory was built up by people who moved into the community as a result of the company's giving them adequate, frequent transportation. As a result of the higher-frequency service installed by the company, and the development of the community resulting therefrom, the company acquired a large number of new customers, and the petitioner's

right became very valuable, as shown by the fact that the right was purchased in January of 1936 by the Railway Equipment and Realty Co., Ltd., for \$212,040.32. As was said in *Houston Natural Gas Corp. v. Commissioner of Internal Revenue*, supra, at 816:

“Courts must look to the substance rather than the form of a particular transaction in applying taxing statutes. *United States v. Phellis*, 257 U.S. 156, 42 S. Ct. 63, 66 L. Ed. 180; *McCaskill Co. v. United States*, 216 U.S. 504, 30 S. Ct. 386, 54 L. Ed. 590. A large list of satisfied customers on the books of this corporation is not merely an aggregation of disconnected individuals, but is a combination of business with a measurable degree of permanency. Its customers, with service lines completely installed, may be depended upon with some degree of certainty to continue to purchase gas from it in the future. In *Gauley Mountain Coal Co. v. Commissioner*, supra, this court said: ‘Intangible property, which enables a taxpayer to save or earn money, is as legitimate a form of capital investment as tangible property.’ Whether it is called good will or something else, is unimportant, so long as it constitutes invested capital.”

The early losses or deficits or the amount for which the earnings of the public utility have failed to meet the ordinary operating expenses, will in the majority of cases very closely measure the cost of developing the business.

See *re Lafayette Telephone Co.*, P.U.R. 1920 A 422, where the Indiana Public Service Commission held that the logical and equitable basis for determining the growing value of a public utility is to capitalize

the unrequited losses and the cost of establishing the business.

In *Houston Electric Company v. City of Houston*, 265 Fed. 360 at 362, the Court said:

“Partly in detail, the development cost embraces preliminary outlays and unrecovered costs in operating the plant itself until a paying business has been established, and subsequently for extensions into sparsely settled territory, until the growth of that particular section affords an adequate return. This cost continues with the continued extension and development of the plant.”

In *Hill, et al. v. Antigo Water Co.*, 3 Wis. Ry. Comm. Rep. 623 at 713, the Commission said:

“As to whether the cost of building up the business should be included in the value of a plant, or gradually charged off from the earnings when these earnings become large enough to warrant it, or rather when they have so increased as to cover operating expenses including depreciation and a reasonable return upon the investment, and, besides this, leave a surplus that may thus be devoted to the wiping out of the cost in question, may not be entirely clear. When added to the original capital upon which interest and profits should be earned, it becomes a permanent charge upon the consumers. This charge, however, is low, as low, in fact, as it very well can be made. When gradually written off, it results in a high annual charge upon the present consumers, but in a charge that will terminate when the cost has been wiped out. Either plan may be feasible. As to which one is preferable is a question that depends upon the circumstances in each particular case.

“When all the facts are considered, however, it will probably be found that in most cases it is better to include these costs in the capital than to attempt to wipe them out in a comparatively brief period through some system of amortization. These costs, as shown, are in the nature of an investment and should therefore, it would seem, be treated as such. They largely belong to the same class of costs as the interest on capital and certain other items for which allowance is made during the construction period. It is true that these costs become a permanent charge when they are included in the capital, and that they are ultimately extinguished when they are written off. But this would not seem to affect the conclusion already stated.”

In the case of *W. E. Decker v. Galen H. Welch, Collector*, 15 A.F.T.R. 1027, the Court held that the taxpayer was entitled to have allowed as capital cost, the amounts spent in increasing circulation of a newspaper, notwithstanding that such amounts were returned during the taxable year as expense or cost of operation.

The Board of Tax Appeals has also upheld this doctrine in the case of *S. C. Toof & Co. v. Commissioner of Internal Revenue*, 21 B.T.A. 916 at 939.

In the case before the Board, the petitioner for the year 1935 charged its losses in the amount of \$52,885.41 as a capital expenditure in developing the entirely new lines to the San Lorenzo and Castro Valley territory (Tr. 51).

It is admitted that the taxpayer charged these expenses in developing the new lines and territory for

the years 1931, 1932, 1933, and 1934 as an ordinary business expense. However, it is well settled that a taxpayer is not irrevocably bound by the erroneous treatment of an item affecting his tax liability either in the matter of accounting or in his tax returns.

United Profit-Sharing Corp. v. United States,
66 Ct. Cl. 171, 6 A.F.T.R. 7850.

The Court of Claims in *United Profit-Sharing Corp. v. United States*, 66 Ct. Cl. 171 at 181, 6 A.F.T.R. 7850 at 7855, in holding that where a company spent large sums in acquainting the public with its advantages for two years in order to get new customers, it should capitalize the sums so spent, said:

“The unusual and extraordinary purpose of the expense had been accomplished. These vast sums of money were expended for the sole purpose of procuring contracts from which plaintiff might derive profit. They were not ordinary expenses. They were, in a proper sense, capital expenditures, and should have been spread over a period of years in determining plaintiff’s tax liability.”

In the case before this Court the petitioner, knowing it would suffer a loss for a considerable period, put on a high-frequency schedule instead of a skeleton schedule in order to develop the territory and acquire new customers. This was the result of its policy, and a valuable right was developed. It should capitalize the losses incurred in the promotion of the new territory and right.

CONCLUSION.

For the reasons above noted, petitioner respectfully submits that the decision of the United States Board of Tax Appeals that there are deficiencies for 1936 of \$25,289.85 in income tax and \$9,609.39 in excess-profits tax was erroneous and should be reversed.

Dated, San Francisco,

October 6, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner.

No. 9891

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

PEERLESS STAGES, INC., A CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS**

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

**J. L. MONARCH,
HARRY MARSELLI,**
Special Assistants to the Attorney General.

FILED

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CLERK

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	2
Summary of argument.....	6
Argument:	
The losses resulting from the operation of certain bus lines in earlier years cannot be capitalized and used as the basis for determining gain from the "sale" thereof in the taxable year..	7
Conclusion.....	22
Appendix.....	23

CITATIONS

Cases:

<i>Beals' Estate v. Commissioner</i> , 82 F. (2d) 268.....	22
<i>Bretzfelder v. Commissioner</i> , 21 B. T. A. 789.....	18
<i>Burnet v. Sanford & Brooks Co.</i> , 282 U. S. 359.....	8
<i>Chicago & N. W. R. Co. v. Commissioner</i> , 114 F. (2d) 882.....	21
<i>Crocker First Nat. Bank v. Commissioner</i> , 59 F. (2d) 37.....	10, 15
<i>First National Bank of Skowhegan v. Commissioner</i> , 35 B. T. A. 876.....	18
<i>Galveston Elec. Co. v. Galveston</i> , 258 U. S. 388.....	15
<i>Gaylord v. Commissioner</i> , 41 B. T. A. 1119.....	18
<i>Giurlani, A., & Bro., Inc. v. Commissioner</i> , 119 F. (2d) 852.....	10
<i>Hill v. Antigo Water Co.</i> , 3 Wis. R. Comm. Rep. 623.....	15
<i>Home Trust Co. v. Commissioner</i> , 65 F. (2d) 532.....	10
<i>Houston Natural Gas Corp. v. Commissioner</i> , 90 F. (2d) 814, certiorari denied, 302 U. S. 722.....	17
<i>Huntington Securities Corp. v. Busey</i> , 112 F. (2d) 368.....	21
<i>LaBelle Iron Works v. United States</i> , 256 U. S. 377.....	10, 15
<i>Lucas v. American Code Co.</i> , 280 U. S. 445.....	21
<i>Meredith Pub. Co. v. Commissioner</i> , 64 F. (2d) 890, certiorari denied, 290 U. S. 646.....	17
<i>News Pub. Co. v. Blair</i> , 29 F. (2d) 955.....	17
<i>Newspaper Printing Co. v. Commissioner</i> , 56 F. (2d) 125.....	18
<i>Parkersburg Iron & Steel Co. v. Burnet</i> , 48 F. (2d) 163.....	10, 15
<i>Red Wing Malting Co. v. Willcutts</i> , 15 F. (2d) 626, certiorari denied, 273 U. S. 763.....	17
<i>Schram v. United States</i> , 118 F. (2d) 541.....	21
<i>Surety Finance Co. v. Commissioner</i> , 77 F. (2d) 221.....	17
<i>Welch v. Helvering</i> , 290 U. S. 111.....	18
<i>Willcutts v. Minnesota Tribune Co.</i> , 103 F. (2d) 947.....	17

Statutes:

Revenue Act of 1928, c. 852, 45 Stat. 791:	Page
Sec. 21.....	25
Sec. 22.....	25
Sec. 23.....	25
Sec. 24.....	25
Sec. 41.....	25
Sec. 43.....	25

Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 21.....	25
Sec. 22.....	25
Sec. 23.....	25
Sec. 24.....	25
Sec. 41.....	25
Sec. 43.....	25

Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 21 (U. S. C., Title 26, Sec. 21).....	25
Sec. 22 (U. S. C., Title 26, Sec. 22).....	25
Sec. 23 (U. S. C., Title 26, Sec. 23).....	25
Sec. 24 (U. S. C., Title 26, Sec. 24).....	25
Sec. 41 (U. S. C., Title 26, Sec. 41).....	25
Sec. 43 (U. S. C., Title 26, Sec. 43).....	25

Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 21.....	23
Sec. 22.....	23
Sec. 23.....	23
Sec. 24.....	24
Sec. 41.....	24
Sec. 43.....	24
Sec. 111.....	25
Sec. 113.....	25

Miscellaneous:

Treasury Regulations 74:	
Art. 121.....	8, 29
Art. 282.....	9, 29
Art. 323.....	30
Art. 341.....	30
Art. 342.....	30

Treasury Regulations 77:	
Art. 121.....	8, 29
Art. 282.....	9, 29
Art. 323.....	30
Art. 341.....	30
Art. 342.....	30

Treasury Regulations 86:	
Art. 23 (a)-1.....	8, 29
Art. 24-2.....	9, 29
Art. 41-3.....	30
Art. 43-1.....	30
Art. 43-2.....	30

Miscellaneous—Continued.

Treasury Regulations 94:	Page
Art. 23 (a)-1.....	26
Art. 23 (l)-7.....	16
Art. 23 (m)-15.....	16
Art. 23 (m)-16.....	16
Art. 23 (m)-23.....	16
Art. 24-2.....	26
Art. 41-3.....	27, 30
Art. 43-1.....	28
Art. 43-2.....	28
Art. 113 (b)-1.....	29

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 9891

PEERLESS STAGES, INC., A CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion is that of the Board of Tax Appeals (R. 94-98), which is reported at 43 B. T. A. 111.

JURISDICTION

This petition for review involves deficiencies in income and excess profits taxes for the year 1936, in the respective amounts of \$25,289.85 and \$9,609.39, and is taken from a decision of the Board of Tax Appeals entered December 20, 1940. (R. 98-99.) The case is brought to this Court by a petition for review filed March 11, 1941 (R. 99-106), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the excess of the cost of operation of certain bus transportation lines over receipts therefrom in prior years may be capitalized by the taxpayer and used as its basis for computing gain from the "sale" thereof in 1936, or whether those operating losses were deductible only in their respective years.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations may be found in the Appendix, *infra*, pp. 23-30.

STATEMENT

The facts found (R. 94-96) by the Board of Tax Appeals, from testimony and exhibits adduced in evidence before it (R. 28-94), may be stated as follows:

The petitioner, Peerless Stages, Inc. (hereinafter referred to as the taxpayer), is a California corporation organized in 1923 and having its principal office in Oakland. It had taken over, when organized (R. 41-42), a bus transportation system between Oakland, Palo Alto, San Jose, and Santa Cruz (California), which four individuals had theretofore been operating under a certificate of the California State Railroad Commission. The four individuals became its only stockholders and were four of its five directors. (R. 94-95.)

The area between Oakland and Hayward contained much orchard and tomato land about 1931. For several years before 1931, a street car line had been operated (by others) between those points, and the taxpayer was

giving it intermediate bus service as a part of its inter-city service between Oakland and San Jose. The taxpayer considered two alternative plans for providing the area with transportation, one, a skeleton service which would merely take care of the existing demand, and the other, a more frequent service at twenty-minute intervals. The taxpayer adopted the twenty-minute service plan and in 1931 established a local service between Oakland and Hayward (along East 14th Street), under which the buses stopped at any corner to take on or discharge passengers. In addition, the taxpayer continued its inter-city service over that route. The area developed rapidly. (R. 95.) (~~See R. 43-47.~~)

In 1933, the taxpayer filed with the State Railroad Commission an application for authority to extend its local bus service to the Castro Valley and San Lorenzo areas (two areas lying a little to the north and south, respectively, of its Oakland-to-Hayward route along East 14th Street). Authority was granted and in 1934 the taxpayer instituted a new local service to those areas, on a twenty-minute frequency, and that new service, coordinated with the existing local service, resulted in ten-minute service to certain areas (along East 14th Street). (R. 95.)

A summary of the results of the operation of the two new local services above mentioned, showing the miles traveled, the passenger and express receipts, the yearly loss from operation of the new local service, computed by deducting from transportation revenues the transportation expenses, self-insurance charges, and depre-

ciation adjustments, is shown in the following table (R. 96):¹

	Miles	Receipts	Loss
1931	282, 127	\$48, 356. 91	\$15, 613. 54
1932	328, 860	58, 230. 04	11, 230. 94
1933	342, 513	63, 355. 05	516. 47
1934	753, 967	101, 640. 22	39, 459. 22
1935	839, 046	108, 550. 72	52, 885. 41
Total			119, 705. 58

In 1935, the taxpayer's directors contemplated abandoning the new local routes to another transportation company, and on January 14, 1936, a contract to that end (R. 17-25) was entered into between the taxpayer and the Railway Equipment & Realty Company, Ltd., (under which the taxpayer agreed to abandon its service on the new local routes, it being contemplated that service thereon would be rendered thereafter by East Bay Street Railways, Ltd., a corporation owned by the equipment company). Under it the taxpayer also sold fifteen of its buses. The consideration under the con-

¹ This table represents (to the exclusion of all of the taxpayer's other services) the total results of the operation of the two new services, the first one being the local service along East 14th Street and represented on the table in the figures for the years 1931, 1932 and 1933; the second one being the local service to the Castro Valley and San Lorenzo areas, started in 1934 and reflected in the figures set out in the table for the years 1934 and 1935. Itemized statements showing, both as to the new services and as to all other services of the taxpayer, the transportation revenues, and the transportation expenses, consisting of the various items expended for conducting transportation, maintenance, traffic, and miscellaneous matters, for the years 1931 to 1935, inclusive, are set out in detail in the record. (Exhibits Nos. 2 to 6, both inclusive, R. 53-65.)

tract was \$180,000, plus \$30,000 designated as reimbursement for the taxpayer's local service operating deficit from April 1 to December 31, 1935, and an additional sum for the taxpayer's local service operating deficit from January 1, 1936, to the date of the actual abandonment of the local service (R. 96)—the total received by the taxpayer being \$216,540.32 (R. 5).

On its income tax returns for the years 1931 to 1934, inclusive, the taxpayer had deducted from its current income for each of the years the losses from the operation of the new routes. On May 21, 1936, the taxpayer filed amended returns for those four years, and on them, and also on the return filed for 1935, it treated the losses resulting from the operation of the new routes (aggregating \$119,705.58) as having been capitalized. (R. 96.)

In its income tax return for the year 1936, in reporting its capital gain resulting from the transaction (under its contract for the abandonment of its local service routes), the taxpayer reported a capital gain of \$92,334.74,² by including in its basis the \$119,705.58 of aggregate losses from the operation of the local services in question for the years 1931 to 1935, inclusive (R. 96-97).

The Commissioner, in his audit, increased the amount of the gain from the transaction to \$212,040.32, by eliminating the \$119,705.58 from the basis, holding that the operating losses of the years 1931 to 1935, inclusive, could not be capitalized. The Commissioner, accord-

² This figure is erroneously given as \$92,234.14 in the Board's opinion (R. 96), but see R. 15.

ingly, determined deficiencies in income and excess profits taxes for the year 1936. (R. 12-17, 97.)

From the Commissioner's determination, the taxpayer appealed to the Board of Tax Appeals, contending that the excess of the operating expenses over operating receipts from the new routes in question constituted capital expenditures, which were not properly deductible in the year of operation. (R. 3-11.) The Board of Tax Appeals upheld the action of the Commissioner (R. 97-98), and sustained the deficiencies asserted against the taxpayer (R. 98-99).

The taxpayer brings the question thus presented to this Court for review. (R. 99-106.)

SUMMARY OF ARGUMENT

In determining the gain from the "sale" of the bus lines in question in 1936, the taxpayer is not entitled to capitalize and use as part of its basis the losses from the operation of those routes during the prior years of 1931 to 1935, inclusive. The losses of the earlier years which the taxpayer is seeking to capitalize are merely the excess of the expenses of operation over the receipts therefrom during the prior years. The expenses in question consisted entirely of expenses clearly attributable to current operation, and they were currently deductible from income in the respective earlier years of operation. Hence, they cannot be capitalized in the year of "sale" and be used to reduce the profit resulting from the "sale."

Moreover, since the taxpayer did not *sell* the routes in question nor its so-called "operative rights"—but merely agreed to abandon them—it is not in any event

entitled to use any basis in respect of them, because under the statute a basis may be used only in the case of a "sale or other disposition" of property.

ARGUMENT

The losses resulting from the operation of certain bus lines in earlier years cannot be capitalized and used as the basis for determining gain from the "sale" thereof in the taxable year

During the taxable year 1936 the taxpayer, under a contract with the Railway Equipment and Realty Company, Ltd., agreed to abandon its local service routes in question and transferred certain buses. (R. 17-25, 96.) The total consideration received by the taxpayer under that contract was \$216,540.32. (R. 5.) In reporting its profit on that transaction, the taxpayer, in its 1936 return, reported a capital gain of \$92,334.74. (R. 15.) The Commissioner, in his determination, increased the amount of the gain to \$212,040.32. (R. 15, 96-97.) Thus, the difference between the respective computations of profit by the parties amounts to \$119,705.58, and upon that difference the present controversy is centered. The only dispute between the parties is whether, in computing its gain under the contract, the taxpayer is entitled to capitalize and use as part of its cost basis the total of \$119,705.58 of the losses from the operation of the services in question during the prior years of 1931 to 1935, inclusive. The taxpayer contends that the operating losses of the prior years may be capitalized and used as part of its basis in computing the profit. The Board of Tax Appeals, sustaining the position of the Commissioner, held that since the losses in question con-

sisted entirely of operating expenses, they could only be deducted in the respective years of operation and could not be capitalized and be used to compute the profit. (R. 96-98.) We submit that the decision of the Board of Tax Appeals is unquestionably correct and should, therefore, be affirmed.

Under our system of income taxation upon the basis of annual periods (*Burnet v. Sanford & Brooks Co.*, 282 U. S. 359), provision is made in the statute for the deduction, in arriving at taxable net income, of all the ordinary and necessary expenses of carrying on a trade or business. Section 23 (a) of the Revenue Act of 1936, Appendix, *infra*. A similar provision is contained in the earlier Revenue Acts applicable to all of the earlier years of operation here involved. Section 23 (a) of the Revenue Acts of 1928, 1932 and 1934. Under the applicable Regulations, those "ordinary and necessary expenses" of carrying on a trade or business, allowed by the statute as deductions in the computation of net income, have been defined and described in greater detail under the general heading of "Business Expenses." Article 23 (a)-1 of Regulations 94 (promulgated under the Revenue Act of 1936), Appendix, *infra*. The earlier Regulations contained similar provisions. Article 23 (a)-1 of Regulations 86 (promulgated under the Revenue Act of 1934), Article 121 of Regulations 77 (promulgated under the Revenue Act of 1932), and Regulations 74 (promulgated under the Revenue Act of 1928). In addition, in laying down the pattern to be used in the computation of the annual taxable net income, the statutes have specifically provided that no

deduction should be allowed in respect of amounts paid for new buildings or permanent improvements or betterments to property. Section 24 (a) (2) of the Revenue Act of 1936, Appendix, *infra*, and of the Revenue Acts of 1934, 1932, and 1928. Under this statutory provision, the Regulations have stated, generally, under the heading of "Capital Expenditures," that amounts paid for increasing the capital value of property are not deductible from gross income, and have enumerated in detail several examples of expenditures which are to be regarded as capital expenditures, not deductible from current income. Article 24-2 of Regulations 94, Appendix, *infra*, Article 24-2 of Regulations 86, and Article 282 of Regulations 77 and 74. In keeping with this statutory pattern for the computation of current annual income, further provision is made in the statute for an adjustment on account of expenditures chargeable to capital account, to be made to the cost or other basis of property which is to be used in the computation of gain or loss from the sale or other disposition of property. Section 113 (b) (1) (A) of the Revenue Act of 1936, Appendix, *infra*.

Thus, under the statutory scheme for the taxation of income, an annual computation of the income is to be made, under which computation the deduction of the expenses attributable to the current operation or *carrying on* of the business is currently permitted, while no deduction is permitted to be made from the current gross income for items which represent capital expenditures. Quite obviously, under that scheme, items which represent expenditures for the current operation of the

business cannot be capitalized, just as, conversely, capital items cannot be charged against current income as part of the cost of operation. Of course, to the extent that capital expenditures are made for depreciable or depletable assets, a deduction is allowed annually against current income of a proportionate part of the item, spread over its estimated life, by way of a depreciation or depletion allowance. Section 23 (l) and (m) of the Revenue Act of 1936.

In general, a capital expenditure is an outlay which is made to acquire some property, the usefulness of which in the business will last more than the current taxable year. See *LaBelle Iron Works v. United States*, 256 U. S. 377, 388; *Home Trust Co. v. Commissioner*, 65 F. (2d) 532 (C. C. A. 8th), and *A. Giurlani & Bro. Inc. v. Commissioner*, 119 F. (2d) 852, 857-858 (C. C. A. 9th). The best illustrations of capital expenditures are amounts expended for such things as plant construction, machinery, equipment, furniture and fixtures, etc. See Article 41-3 of Regulations 94, Appendix, *infra*. Quite obviously, such items are not to be deducted from current income because their usefulness in the business will last for more than the current taxable year, and they are, therefore, charged to capital account or capitalized. Whether a particular expenditure is a capital one or whether it represents an ordinary operating expense depends upon the nature of the expenditure. *Crocker First Nat. Bank v. Commissioner*, 59 F. (2d) 37, 39 (C. C. A. 9th), and *Parkersburg Iron & Steel Co. v. Burnet*, 48 F. (2d) 163, 165 (C. C. A. 4th). In other words, in resolving the problem, it must be borne in mind that the question of

whether a particular expenditure is an ordinary expense of operation or one for the acquisition of a capital asset is a question to be determined from the circumstances and the nature of the expenditure itself.

When consideration of the instant case is approached with these principles in mind, it is obvious at the very outset that the losses from the operation of the local routes during the earlier years, which the taxpayer is seeking to capitalize, are clearly not capital expenditures. The losses which the taxpayer is seeking to capitalize are merely the excess of the operating expenses over the operating receipts from the routes in question during the prior years. (R. 97.) When the items of the expenditures made by the taxpayer during those earlier years are individually analyzed, it is clear, beyond any shadow of a doubt, that they constitute mere expenses of current operation—all of which stand out in clear distinction from and bold contrast to capital expenditures. There is certainly nothing of a “capital” nature in any of the expenditures in question made for drivers’ wages, gasoline, oil, service car expenses, station salaries, station expenses, shop expenses, miscellaneous transportation expense, etc. (R. 81.) An examination of the statements for the years 1931 to 1935, inclusive, wherein the expenses in question are itemized (R. 53–65), definitely establishes that the losses which are sought to be capitalized by the taxpayer consist of nothing more than items clearly attributable to current operation (R. 80–82).

The mere fact that the payment of those current operating expenses by the taxpayer during the earlier years had the result of building up a good business,

with a valuable good will as a going enterprise, as the taxpayer argues (Br. pp. 10, 12-13), does not change the character of the expenses to capital items, we submit. Every operating expense made in carrying on a business, new or old, has more or less the same result of building up a valuable business—or, at least, is calculated to build up a valuable business, and is obviously generally made with such hope or expectation. For example, every item of the expenses of conducting a merchandising store, such as rent, clerk hire, etc., may generally be regarded as contributing to the building up of a valuable business and good will. However, it could hardly be said that those items of operating expenses would acquire a “capital” nature for the purposes of computing taxable income. As has been seen, for tax purposes, expenditures must be classified (as between operating and capital) according to their true nature. Quite obviously, the excess of operating expenses over receipts cannot acquire the nature of capital expenditures merely because the operating expenses had the result of building up a valuable business. If the operating expenses of the taxpayer were ordinary current business expenses when made during the years 1931 to 1935, they must retain their character of operating expenses—and they cannot be changed to capital expenditures in 1936 merely because of the realization of the fact that they had succeeded in building up a valuable business.

The unique and somewhat far-fetched treatment of its earlier operating expenses contended for by the taxpayer seems to be predicated upon the proposition that

its directors realized, when the frequent local service was entered into, that it would be operated at a loss until the business developed sufficiently. (Br. 9, 12.) But even such a realization does not warrant any exceptional treatment of the taxpayer's operating expenses of the earlier years, we submit. That same circumstance might, and perhaps does, exist in the case of almost all new businesses. A person starting a new retail store, for example, may well realize that his operating expenses may exceed his profits from sales at first, until the business develops, but that does not change the character of his operating expenses—they must remain operating expenses, and cannot be capitalized. Nor should any different result follow in the instant case merely because here the taxpayer had two alternative courses to follow in the starting of these new local services: the first, the skeleton service which would have been adequate to take care of the existing needs of the territory and which would probably have shown no loss, or even a small profit, and the other, the frequent service which, it was realized, would show losses until the business developed. (See Pet. Br. 9, 12, 16 and R. 75, 77-78.) This same choice of alternatives might confront every person establishing a new business, but it in no way justifies the changing of operating expenses to capital expenses. The mere fact that more drivers are employed than are presently needed at first to meet the current requirements of the territory (Cf. R. 82) quite obviously would not make the expenses for the

additional salaries take on a character of capital expenditures, we submit.

No merit is accorded to the taxpayer's unique claim for capitalizing earlier operating expenses by the fact that the operation of the routes in question took place under authority of the State of California. It must be borne in mind, first of all, that the permission to operate the services was not an exclusive right or franchise (R. 30) and that, in fact, others could and did engage in operations in the same areas (R. 31, 79). But, in any event, the presence of a permit or an operating franchise would not authorize the taxpayer to capitalize current expenses of operation.

In final analysis, the position of the taxpayer seems to be no more than a contention that the earlier operating losses of its business in question can be capitalized because they constituted "development expenses," in that they resulted in building up a valuable business or right. (Br. 12, 16.) Of course, it is immaterial here whether for other purposes the early operating losses of a business might be regarded as development expenses and be capitalized as such. It may be true that there is some support for the taxpayer's theory of capitalizing early operating deficits in some of the so-called "rate" cases. While we see no occasion to indulge in an exhaustive analysis of the authorities in that field, it may be observed in passing that the Supreme Court has held that past deficits from operations during earlier years could not be included as development cost in the base value for the purpose of deter-

mining whether a rate is confiscatory. *Galveston Elec. Co. v. Galveston*, 258 U. S. 388, 392–397.³

But, regardless of how they might be treated for other purposes, the operating losses of earlier years cannot be capitalized for income tax purposes, we submit. The controlling consideration here is that the expenses of current operation of a business are currently deductible from income under our income tax law, and they may not be capitalized. As we have already observed, in the field of income taxation a capital expenditure is an amount paid out for something of a more or less permanent use in a business (*Crocker First Nat. Bank v. Commissioner*, 59 F. (2d) 37, 39 (C. C. A. 9th), and *LaBelle Iron Works v. United States*, 256 U. S. 377, 388), as contrasted to amounts paid out for “carrying on” the business, which are currently deductible under Section 23 (a) of the statute. The true test, in each substance, is “the nature of the expenditure in and of itself.” *Parkersburg Iron & Steel Co. v. Burnet*, 48 F. (2d) 163, 165 (C. C. A. 4th.) Under that test, all of the expenses in the earlier years here involved were ordinary operating expenses, and they were, therefore, currently deductible from income in the respective years of operation—and they cannot be capitalized. This result must follow, notwithstanding the claim that the earlier expenses resulted in building up a valuable business or right in the taxpayer. As

³ In so holding, the Supreme Court refused to follow the so-called Wisconsin rule of such cases as *Hill v. Antigo Water Co.*, 3 Wis. R. Comm. Rep. 623, 713, 723, quoted by the taxpayer in its brief (pp. 14–15.)

we have already suggested, the expenses of carrying on any new business might similarly be claimed to be "development expenses" on the ground that they contributed to building up the business and to creating an asset of value, good will or going-concern value. In that respect, the taxpayer's situation is no different from that of any other business and the taxpayer is entitled to no different treatment under the tax laws upon the basis of any such claim. The taxpayer cannot capitalize what were merely ordinary operating expenses of earlier years—no more than any other business man or merchant could capitalize the earlier operating losses of his business.

It is, of course, true that under our scheme of income taxation some provisions are made for taking into account so-called development expenses in some special cases. For example, in dealing with the subject of depletion in the case of oil and gas wells, it is provided that so-called "intangible" drilling and development costs may be deducted as current expenses or may be charged to capital account, at the taxpayer's option. Article 23 (m)-16 of Regulations 94. In dealing with depletion in the case of mines, it is provided that expenditures in the development stage may be charged to capital account. Article 23 (m)-15 of Regulations 94. Likewise, in the case of timber, provision is made for the recovery of cost of development through depreciation. Article 23 (m)-23 of Regulations 94. As to patents, depreciation is allowed based on cost, including development or experimental expenses. Article 23 (l)-7 of Regulations 94. It is further recognized that

depreciation may be taken in respect of intangibles used in a business which have a limited life, such as patents and trademarks, licenses and franchise, while no depreciation may be taken of intangibles which do not have a limited life. Article 23 (1)-3 of Regulations 94. But no deduction for depreciation, including obsolescence, is allowable in respect of good will. Article 23 (1)-3 of Regulations 94. See *Red Wing Malting Co. v. Willcutts*, 15 F. (2d) 626 (C. C. A. 8), certiorari denied, 273 U. S. 763. Although many capital expenditures may, because of their nature, be recovered through annual charges against income, or by depreciation allowances, etc., it is quite clear that not all capital expenditures may be amortized or charged back against income. See *Surety Finance Co. v. Commissioner*, 77 F. (2d) 221 (C. C. A. 9th.)

In the instant case, the taxpayer, as the Board properly recognized in its opinion (R. 97-98), may possibly have been entitled to capitalize some of the expenses in the earlier years if it had specifically identified them as expenses attributable to capital, as has been held in certain cases in respect of the cost of solicitation of new business, or of increasing the circulation of a newspaper, etc. Cf. *Houston Natural Gas Corp. v. Commissioner*, 90 F. (2d) 814 (C. C. A. 4th), certiorari denied, 302 U. S. 722; *Meredith Pub. Co. v. Commissioner*, 64 F. (2d) 890 (C. C. A. 8th), certiorari denied, 290 U. S. 646; *Willcutts v. Minnesota Tribune Co.*, 103 F. (2d) 947 (C. C. A. 8th), and *News Pub. Co. v. Blair*, 29 F. (2d) 955 (App. D. C.) That involves simply a recognition of the fact that a capital expenditure may be one

made for intangible assets, including good will, as well as one made for tangible assets, such as machinery or furniture, etc. See *Newspaper Printing Co. v. Commissioner*, 56 F. (2d) 125 (C. C. A. 3d.) But, as the Board pointed out (R. 97, 98), the taxpayer here failed to identify any of its expenditures of the earlier years as capital items. To simply claim that the entire excess of cost of operation in the earlier years over receipts therefrom was a capital expenditure obviously is not enough. In view of the burden which was on the taxpayer (*Welch v. Helvering*, 290 U. S. 111, 115), it was incumbent upon the taxpayer to establish specifically which, if any, of the earlier expenditures were attributable to capital instead of operation. See *Surety Finance Co. v. Commissioner*, *supra*, p. 224, and *Meredith Pub. Co. v. Commissioner*, *supra*, p. 893. Therefore, in any event, under the rule recognized in these authorities, since the taxpayer failed to establish which, if any, of the earlier expenditures were capital expenditures, the denial of the right to capitalize the entire amount must be sustained. See *Houston Natural Gas Corp. v. Commissioner*, *supra*, p. 817.

In this connection, we may point out that, because of the very nature of the problem involved, cases involving the classification of expenses are indeed difficult to harmonize, and that each case must turn upon its own particular circumstances. See *Welch v. Helvering*, *supra*, p. 115; cf. *Gaylord v. Commissioner*, 41 B. T. A. 1119; *First National Bank of Skowhegan v. Commissioner*, 35 B. T. A. 876; *Bretzfelder v. Commissioner*, 21 B. T. A. 789; cf. also *A. Giurlani & Bro., Inc. v. Commissioner*, *supra*.

As we have shown, the general scheme of income taxation upon the basis of annual periods calls for charging against current income all of the expenses of *operation* of the business, so that each year's computation will truly reflect the income for that year. Capital expenses cannot be charged against current income, and current operating expenses cannot be capitalized. This is made all the more clear by the additional provision of the statute that deductions must be taken in the year in which paid or incurred (Section 43 of the Revenue Act of 1936, Appendix, *infra*), and by the further provision of the Regulations that the expenses or the deficit of one year cannot be used or carried forward to the next year. Article 43-1 and 43-2 of Regulations 94, Appendix, *infra*.

In other words, the taxpayer was obliged to take these deductions for the operating expenses of the earlier years in those earlier years, when they were paid or incurred, and cannot carry them forward to the taxable year 1936, either as part of its basis or in any other manner.

It may be observed in passing that the taxpayer here had properly currently deducted the operating expenses of the earlier years in computing its income in the respective years of operation, in its returns for the years 1931 to 1934, inclusive. (R. 96.) The attempted change in the treatment of those operating expenses significantly came about after the taxpayer had made the "sale" in question in January of 1936. (R. 96.) It was only after the "sale" that amended returns were filed for the years 1931 to 1934, in which the operating losses were capitalized, and additional taxes paid. (R.

85.) As a matter of fact, the record shows that after the "sale" came up for consideration, the directors of the taxpayer "felt that there was going to be quite a tax problem involved." (R. 71.) Then Mr. Weiser, auditor and secretary of the taxpayer (R. 40-41), looked into the problem (R. 72), and apparently produced this unique but advantageous plan for handling it—namely, this theory of capitalizing early operating deficits as development costs. By the paying of additional taxes (R. 7) of \$101.40 for 1931, \$2,415.94 for 1932, and \$3,269.22 for 1934, and by capitalizing the \$52,885.41, operating loss for 1935 (R. 96), the taxpayer's plan for this change of treatment of the expenses of the earlier years would reduce the gain from the transaction by more than \$119,000, and would effect a savings of the taxes involved in the present controversy, amounting to almost \$35,000—if successful. But we submit, the Board of Tax Appeals properly refused to permit this change of treatment and properly held that the operating expenses of the earlier years were deductible only in the respective years of operation. We might point out, further, that that decision inflicts no injury or loss upon the taxpayer, because the taxpayer protected itself against loss by filing claims for the refund of the overpayments which would result as to the earlier years if the taxpayer is unsuccessful in its claim in the present proceeding. (R. 33-35, 83-84.)

In conclusion, we submit that the decision of the Board, sustaining the determination of the Commissioner as to the proper treatment of the expenses of

operation for the earlier years, is eminently sound and correct on the present record, and should, therefore, be sustained. Even if there were any doubt about the matter—which there obviously is not—the action of the Commissioner should be upheld, not only because of the presumption of correctness which ordinarily attaches to it, but also because the matter involved is one of accounting, over which the Commissioner has broad discretionary powers to make changes so as to clearly reflect the taxpayer's income. Section 41 of the Revenue Act of 1936, Appendix, *infra*; See *Lucas v. American Code Co.*, 280 U. S. 445. See also *Chicago & N. W. R. Co. v. Commissioner*, 114 F. (2d) 882 (C. C. A. 7th); *Huntington Securities Corp. v. Busey*, 112 F. (2d) 368 (C. C. A. 6th); *Schram v. United States*, 118 F. (2d) 541 (C. C. A. 6th.)

Moreover, entirely aside from the foregoing, there is an additional reason for the affirmance of the decision of the Board in the instant case. The Board refused to permit the capitalizing of the losses of earlier years as part of the basis under Section 113 (b) (1) (A) of the statute for determining the gain “from the sale or other disposition of property” under the contract in question. If the taxpayer has made no “sale or other disposition,” the decision of the Board denying the right to use the earlier losses as “basis” is in any event correct, because a “basis” may be used under the statute as an offset against “the amount realized” only in the case of a “sale or other disposition of property.” In other words, if the transaction was not a “sale or other disposition,” the taxpayer in any event is not

entitled to capitalize any amounts as basis or to use any basis at all. The taxpayer is attempting to use the earlier losses as the basis for its so-called "operative rights." But the taxpayer, under the contract, sold only the 15 buses, the basis of which is not involved in the present controversy. It did not sell or dispose of its "operative rights" to the Equipment company. It merely agreed to abandon its local service routes. (R. 19.) It could not and did not sell or transfer them or the right to operate them to the Equipment company—only the State Railroad Commission could grant permission to operate. Therefore, the taxpayer's agreement at the most is like a promise not to engage in a certain business and that is not "a conveyance of property" and the payment received therefor is not "proceeds received on disposal of a capital asset." *Beals' Estate v. Commissioner*, 82 F. (2d) 268, 270 (C. C. A. 2).

CONCLUSION

It is submitted that the decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

J. L. MONARCH,
HARRY MARSELLI,

Special Assistants to the Attorney General.

OCTOBER, 1941.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 21. NET INCOME.

“Net income” means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has

not taken or is not taking title or in which he has no equity.

* * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule*.—In computing net income no deduction shall in any case be allowed in respect of—

* * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

* * * *

PART IV—*Accounting Periods and Methods of Accounting*

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

* * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

* * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

* * * * *

Sections 21, 22 (a), 23 (a), 24 (a) (2), 41, and 43 of the Revenue Acts of 1928 (c. 852, 45 Stat. 791), 1932 (C. 209, 47 Stat. 169), and 1934 (c. 277, 48 Stat. 680), contain provisions similar to those above quoted.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (a)-1. *Business expenses.* — Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. * * * Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 23 (a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. * * * The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24.

ART. 24-2. *Capital expenditures.* — Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (1).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an

ordinary and necessary business expense, are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See article 22 (a)-17.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Act, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

ART. 41-3. *Methods of accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and article 54-1.) Among the essentials are the following:

*

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*

(2) Expenditures made during the year should be properly classified as between capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account;

* * * * *

ART. 43-1. "*Paid or incurred*" and "*paid or accrued*."—(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in Title I (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Act, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

* * * * *

ART. 43-2. *When charges deductible*.—Each year's return, so far as practicable, both as to

gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his account. * * *

ART. 113 (b)-1. *Adjusted basis: General rule.*—* * * The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. * * * In the case of unimproved and unproductive real property, carrying charges, such as taxes and interest, which have not been taken as deductions by the taxpayer in determining net income for the taxable year, or a prior taxable year, are properly chargeable to capital account.

* * * * *

Articles 23 (a)-1 of Regulations 86 (promulgated under the Revenue Act of 1934), and 121 of Regulations 77 (promulgated under the Revenue Act of 1932), and Regulations 74 (promulgated under the Revenue Act of 1928), contain provisions similar to the above quoted provisions of Article 23 (a)-1 of Regulations 94. Articles 24-2 of Regulations 86 and 282 of Regulations 77

and 74 contain provisions similar to the above quoted portion of Article 24-2. Articles 41-3 of Regulations 86 and 323 of Regulations 77 and 74 contain provisions similar to the above quoted provisions of Article 41-3 of Regulations 94. Articles 43-1 and 43-2 of Regulations 86 and 341 and 342 of Regulations 77 and 74 contain provisions similar to the above quoted portions of Articles 43-1 and 43-2, respectively, of Regulations 94.

United States
Circuit Court of Appeals
For the Ninth Circuit.

NEW YORK LIFE INSURANCE COMPANY, a
Corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the District of Arizona.

FILED

OCT - 1 1941

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

NEW YORK LIFE INSURANCE COMPANY, a
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Appellant,

VS.

LOIS ROGERS,
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Transcript of Record

**Upon Appeal from the District Court of the United
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in

Page

Answer to Amended Complaint	22
Appeal:	
Designation of Contents of Record (Circuit Court of Appeals):	
Appellant	232
Appellee	234
Designation of Contents of Record (District Court):	
Defendant	46
Plaintiff	49
Notice of	42
Statement of Points on (Circuit Court of Appeals)	232
Statement of Points to be relied on (District Court)	44
Stipulation waiving bond on	44
Attorneys, Roll of	1
Bond on Removal	15
Certificate of Clerk	72
Complaint	2

Index	Page
Complaint, Amended	18
Designation of Contents of Record on Appeal (Appellant's) (Circuit Court of Appeals)	232
Designation of Contents of Record on Appeal (Appellee's) (Circuit Court of Appeals)	234
Designation of Contents of Record on Appeal (Defendant's) (District Court)	46
Designation of Contents of Record on Appeal (Plaintiff's) (District Court)	49
Instructions:	
Defendant's requested 1	31
Defendant's requested 2	32
Plaintiff's requested 1	26
Plaintiff's requested 2	27
Plaintiff's requested 3	29
Plaintiff's requested 4	30
Plaintiff's requested 6	30
Judgment	37
Names and Addresses of Attorneys	1
Notice of Filing and Hearing Petition for Re- moval	13
Notice of Appeal	42
Order for Removal	17
Order Setting Case for Trial	26
Petition for Removal	7

Index

Page

Removal to District Court:

Bond for	15
Notice of filing and hearing petition for	13
Order for	17
Petition for	7

Statement of Points on Appeal (Circuit Court of Appeals)	232
--	-----

Statement of Points on Appeal (District Court)	44
--	----

Summons	5
---------------	---

Return thereto	6
----------------------	---

Testimony	52
-----------------	----

Charge to Jury	223
----------------------	-----

Exhibits for defendant:

C-1—Letter re application for Life Insurance Policy No. 17507735 Rogers	114
---	-----

E —Letter dated Jan. 23, 1940 to Mr. Z. A. Rogers from D. F. Caskey.....	129
--	-----

F —Instructions to Agents	134
---------------------------------	-----

Exhibits for plaintiff:

1—Weekly Bulletin — The Arizona Branch	62
--	----

3—Life Insurance Policy	86
-------------------------------	----

5—Letter dated October 30, 1939 to New York Life Insurance Co. from Z. A. Rogers	177
--	-----

Index	Page
Witnesses for defendant:	
Caskey, D. F.	
—direct	103
—cross	138
—redirect	153
—recross	157
Lindberg, Arthur F.	
—direct	196
—cross	203
—redirect	209
—recross	211
—redirect	215
Witnesses for plaintiff:	
Caskey, D. F.	
—cross	79
Clem, Stanley	
—direct	170
Davis, Barto C.	
—direct	164
Lindberg, Arthur F.	
—cross	81
Rogers, Gale A.	
—direct	188
Rogers, Lois	
—direct	58
—recalled, direct	183
—cross	186
—recalled, redirect	190

Index

Page

Trial, Motion for New	39
Memo of authorities thereon	40
Order denying	41
Verdict	36
Motion for instructed	33
Order denying	34
Motion to enter Judgment in accord- ance with	39
Order denying	41

ROLL OF ATTORNEYS

Messrs. ELLINWOOD and ROSS,
Title and Trust Building,
Phoenix, Arizona,
Attorneys for Appellant.

Messrs. DOUGHERTY and CHANDLER,
JOHN F. CONNOR, Esquire,
Heard Building,
Phoenix, Arizona,
Attorneys for Appellee. [2*]

*Page numbering appearing at foot of page of original certified Transcript of Record.

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Defendant.

COMPLAINT

Comes now the plaintiff, and for her cause of
action against the defendant complains and alleges:

I.

That the plaintiff is a resident of Maricopa
County, State of Arizona, and that the defendant
is a foreign corporation duly organized and existing
under the laws of the State of New York for the
purposes of conducting and engaging in the life
insurance business, and as such foreign corporation
is authorized and licensed to do business within
the State of Arizona.

II.

That on December 7, 1939, Zeno A. Rogers, now
deceased, made application to the defendant herein
for a life insurance policy for the face amount of
Two Thousand (\$2,000.00) Dollars with the added
feature of double the face of said policy in the
event that the insured should suffer death resulting

directly and independently of all other causes from bodily injuries, effected solely through external, violent and accidental causes.

That said applicant was examined on the same day, and thereafter the said defendant, by and through its agents, delivered to Zeno A. Rogers, the applicant, policy #17-507-735, together with the application of the said Zeno A. Rogers, thereto attached. [3]

III.

That on January 26, 1940, the said Zeno A. Rogers was in an automobile accident and as a result thereof received injuries, and died on January 28, 1940, as a result of said accident; that said Zeno A. Rogers died within the State of Arizona and that his death resulted directly and independently of all other causes from bodily injury effected solely through external, violent and accidental causes, and that such death occurred within sixty (60) days after the sustaining of such injuries.

IV.

That the said Zeno A. Rogers, in the making of said application for insurance and receiving delivery of the same from said defendant, paid the premium required by the company and duly performed all the conditions and agreements of said policy of insurance on his part to be performed, and that the said Zeno A. Rogers was in possession of the policy at the time of his death.

V.

That prior to the beginning of this action, defendant waived the provisions of said policy regarding proofs of loss, and estopped itself from demanding the submission of said proofs of loss, by its repudiation of the aforesaid policy of insurance and its denial of liability under the terms thereof.

VI.

That the plaintiff herein was the wife of the said deceased, and as said wife had an insurable interest in the life of said deceased and was specifically named in said policy as beneficiary of the insured; that the plaintiff has made demand upon the company for the payment of the death benefits under said policy; that said defendant has failed to pay, and has refused to pay, said amount. [4]

VII.

That the plaintiff herein is entitled to recover the sum of Two Thousand (\$2,000.00) Dollars, the face value of said policy, and the additional sum of Two Thousand (\$2,000.00) Dollars, being double the face value of this policy for the accidental death of the said insured, which death resulted directly and independently of all other causes from bodily injury effected solely through external, violent and accidental causes within sixty (60) days after the sustaining of such injuries.

Wherefore, plaintiff prays judgment against the defendant for the sum of Four Thousand (\$4,000.-00) Dollars and for her costs herein incurred.

JOHN FRANCIS CONNOR

Luhrs Tower,
Phoenix, Arizona.

C. H. YOUNG

209 Luhrs Building,
Phoenix, Arizona.

Attorneys for Plaintiff.

Received copy this day of July, 1940.

[Endorsed]: No. 48903 Filed: Walter S. Wilson,
Clerk 10:59 A. M. By M. Michael, Deputy Jul. 5,
1940. [5]

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903-Div. 2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Defendant.

SUMMONS

The State of Arizona to the above named defendant New York Life Insurance Company, a corporation,

You are hereby summoned and required to appear and defend in the above entitled action in the above entitled court, within twenty days, exclusive of the day of service, after service of this summons upon you if served within the State of Arizona, or within thirty days, exclusive of the day of service, if served without the State of Arizona, and you are hereby notified that in case you fail so to do, judgment by default will be rendered against you for the relief demanded in the complaint.

The name and address of plaintiff's attorney is John Francis Connor, Luhrs Tower, Phoenix, Arizona, and C. H. Young, 209 Luhrs Building, Phoenix, Arizona.

Given under my hand and the seal of the Superior Court of the State of Arizona in and for the County of Maricopa, this 5th day of July, 1940.

(Court Seal) WALTER S. WILSON

Clerk

By M. MICHAEL

Deputy Clerk [6]

I hereby certify that I received the within Summons on the 5th day of July, A. D. 1940, at the hour of 11:55 A.M., and personally served the same on the 5th day of July, A. D. 1940 on New York Life Insurance Company, a corporation, being defendant named in said Summons, by delivering to Wilson T. Wright, in person, as a member of the Corporation Commission of the State of Arizona in the County of Maricopa, 2 copies of said Summons to which

was attached a true copy of the Complaint mentioned in said Summons.

Dated this 5th day of July, A. D. 1940.

LON JORDAN

Sheriff

G. C. SCHOONOVER

Deputy Sheriff

Fees—Service\$1.50

No. of miles traveled one way30

Total\$1.80

[Endorsed]: No: 48903 Filed: Walter S. Wilson,
Clerk 4:10 P.M. By M. Michael, Deputy Jul. 6,
1940. [7]

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903—Div. #2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Defendant.

PETITION FOR REMOVAL OF CAUSE TO
UNITED STATES DISTRICT COURT FOR
THE DISTRICT OF ARIZONA

To the Honorable Superior Court of the State of
Arizona, in and for the County of Maricopa:

The petition of New York Life Insurance Company, a corporation, defendant in the above-entitled cause, respectfully shows to this Court:

I.

The above-entitled suit has been brought in this Court and is now pending therein.

II.

Said action is of a civil nature at law and is brought to recover from defendant the sum of \$4,000.00 as damages for the alleged breach of a certain contract of insurance alleged to have been entered into between defendant and plaintiff.

III.

The above entitled action involves a controversy which is wholly between citizens of different states, to-wit: [8] Your petitioner, New York Life Insurance Company, was at the time this suit was commenced, and still is, a foreign corporation created and existing under the laws of the State of New York, and was then, and still is, a resident and citizen of said State of New York and a non-resident of the State of Arizona. Plaintiff, Lois Rogers, was then, and still is, a citizen and resident of the State of Arizona.

IV.

Said action is one of which the District Courts of the United States are given original jurisdiction.

V.

The time within which your petitioner is required by the laws of the State and the rules of this Court to answer or plead to the complaint in the above-entitled action has not yet expired.

VI.

The amount in controversy in said action exceeds \$3,000.00, exclusive of interest and costs, as appears from the allegations of plaintiff's complaint.

VII.

Petitioner presents herewith a bond conditioned that it will enter in the District Court of the United States for the District of Arizona, within 30 days from the date of filing this petition, a certified copy of the record of this suit, and that it will pay all costs that may be awarded by the said District Court in case the said Court shall hold that this suit was wrongfully or improperly removed thereto. [9]

VIII.

Prior to the filing of this petition and of said bond for the removal of this cause, written notice of intention to file the same was given by petitioner to the plaintiff as required by law, a true copy of which said proof of service of the same is hereto attached.

Wherefore, petitioner prays that this Court proceed no further herein except to make an order for removal as required by law, and to accept said bond

and cause the record herein to be removed into said District Court of the United States for the District of Arizona according to the statute in such cases made and provided.

ELLINWOOD & ROSS

WILLIAM A. EVANS

EVERETT M. ROSS

Attorneys for Defendant

807 Title & Trust Bldg.

Phoenix, Arizona

State of Arizona,
County of Maricopa—ss.

Everett M. Ross, being first duly sworn upon his oath, deposes and says: That he is one of the attorneys for the defendant in the above-entitled action; that he has read the foregoing petition and knows the contents thereof; that the same is true and correct of his own knowledge except as to matters which are therein stated upon information and belief, and, as to those matters, he believes it to be true; [10] and that he makes this affidavit for and on behalf of said defendant for the reason that he is familiar with the facts and for the further reason that the petitioner is a foreign corporation, to-wit, a corporation of the State of New York, and that there are no officers of petitioner within the jurisdiction who are capable of verifying the petition.

EVERETT M. ROSS

Subscribed and sworn to before me this 20th day of July, 1940.

[Seal]

LUCILLE HILL

Notary Public

My commission expires: 3/17/41.

[Endorsed]: No: 48903 Filed: Walter S. Wilson,
Clerk 10:10 A. M. By M. S. Grau, Deputy Jul. 20,
1940. [11]

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903, Div. #2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Defendant.

AFFIDAVIT OF SERVICE OF NOTICE OF
FILING AND HEARING PETITION FOR
REMOVAL AND FILING AND APPROV-
ING BOND ON REMOVAL

State of Arizona,
County of Maricopa—ss.

Everett M. Ross being first duly sworn upon his
oath deposes and says that the instrument attached
hereto is a true and correct copy of the Notice

which has been served upon Lois Rogers, plaintiff in the above-entitled cause and upon Charles H. Young and John Francis Connor, attorneys for said plaintiff, together with a true and correct copy of the Petition for Removal and Bond on Removal, as attached to said Notice, and that he personally served said instruments upon said plaintiff and her attorneys by leaving copies of the same at the place of business of said Charles H. Young in the Luhrs Building, Phoenix, Arizona, and at the place of business of said John Francis Connor in the Luhrs Tower, Phoenix, Arizona.

The service of said Notice and copies of the Petition and Bond were made at the hour of 10 o'clock A. M. on the 20th day of July, 1940.

EVERETT M. ROSS [12]

Subscribed and sworn to before me this 22nd day of July, 1940.

My commission expires: 3/17/41.

[Notarial Seal] LUCILLE HILL

Notary Public

[Endorsed]: No: 48903 Filed Walter S. Wilson, Clerk 9:25 A. M. By Ernest R. Morris, Deputy Jul. 20, 1940. [13]

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903—Div. #2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Defendant.

NOTICE OF FILING AND HEARING PETI-
TION FOR REMOVAL AND FILING AND
APPROVING BOND ON REMOVAL

To the above-named Lois Rogers, plaintiff, and to
Charles H. Young, her attorney:

Please take notice that New York Life Insurance Company, the defendant in the above-entitled cause, will, on the 20th day of July, 1940, at 9:30 o'clock A. M., file in the office of the Clerk of the Superior Court of the State of Arizona, in and for the County of Maricopa, its petition, a copy of which accompanies this notice, for the removal of said cause to the District Court of the United States, in and for the District of Arizona, and that the defendant, New York Life Insurance Company, will also, then and there, file a bond with said Clerk, a copy of which also accompanies this notice, and at the hour of 10 o'clock A. M., on the 20 day of July, 1940, or as soon thereafter as counsel may

be heard, said defendant will request said Superior Court to accept said petition and to accept and approve said bond and to cause a certified copy of the record in said cause to be [14] removed unto the said District Court of the United States, in and for the District of Arizona.

Dated this 20 day of July, 1940.

ELLINWOOD & ROSS

WILLIAM A. EVANS

E. M. R

EVERETT M. ROSS

Attorneys for Defendant

807 Title & Trust Bldg.

Phoenix, Arizona

[Endorsed]: No. 48903. Filed: Walter S. Wilson, Clerk. 10:10 A. M. By M. S. Grau, Deputy. July. 20, 1940. [15]

In the Superior Court of the State of Arizona
In and for the County of Maricopa
No. 48903, Div. #2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY,
a corporation,

Defendant.

BOND FOR REMOVAL

Know All Men By These Presents:

That we, New York Life Insurance Company, a corporation, as principal, and Hartford Accident & Indemnity Company, a corporation, duly authorized to engage in a general indemnity and surety business in the State of Arizona, as Surety, are held and firmly bound unto Lois Rogers, her heirs, legal representatives, and assigns in the penal sum of Five Hundred Dollars (\$500.00), lawful money of the United States of America, for the payment of which, well and truly to be made, we bind ourselves, our successors and assigns, jointly and severally by these presents.

The conditions of this obligation are such that, whereas, the said, New York Life Insurance Company, a corporation, has applied by petition to the Superior Court of the State of Arizona, in and for the County of Maricopa, for the removal of the

above-entitled cause from the Superior Court to the District Court of the United States, for the District of Arizona; [16]

Now, if the said New York Life Insurance Company, a corporation, shall enter in the said District Court of the United States for the District of Arizona, within thirty days from the date of filing of the petition for such removal, a certified copy of the record in said suit, and shall well and truly pay all the costs that may be awarded by said District Court if it shall hold that said suit was wrongfully or improperly removed thereto, then this obligation to be void, otherwise to remain in full force and effect.

NEW YORK LIFE INSURANCE
COMPANY, a corporation

By EVERETT M. ROSS

Its Attorney

Principal

HARTFORD ACCIDENT & IN-
DEMNITY COMPANY, a corpo-
ration

By C. G. SULLIVAN

Its Attorney-in-Fact

[Endorsed]: No. 48903. Filed: Walter S. Wilson, Clerk. 10:10 A. M. By M. S. Grau, Deputy. Jul. 20, 1940. [17]

In the Superior Court of the State of Arizona
in and for the County of Maricopa

No. 48903—Div. #2

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY,
a corporation,

ORDER FOR REMOVAL

This cause coming on for hearing upon petition and bond of the defendant, New York Life Insurance Company, a corporation, for the removal of this cause to the District Court of the United States, in and for the District of Arizona, and it appearing to the Court that the defendant has filed its petition for such removal in due form of law and has made and filed a bond duly conditioned, with good and sufficient sureties as provided by law, and has given plaintiff due and legal notice thereof, and it further appearing to the court that this is a proper cause for removal to said District Court,

It is therefore ordered by the Court that said petition and bond be, and they are hereby, accepted, and that this cause be, and it is hereby, removed to the District Court of the United States, in and for the District of Arizona, and that the Clerk of this Court be, and he is hereby, directed to prepare a

certified copy of the record in said cause to be filed in the District Court as required by law.

Done in open court this 20 day of July, 1940.

M. T. PHELPS

Judge

[Endorsed]: No. 48903. Filed: Walter S. Wilson, Clerk. 10:10 A.M. By M. S. Grau, Deputy. Jul. 20, 1940. [18]

[Endorsed]: Record on Removal. Filed Aug. 19, 1940. Edward W. Scruggs, Clerk. United States District Court for the District of Arizona. By Wm. H. Loveless, Chief Deputy Clerk. [19]

In the District Court of the United States
in and for the District of Arizona

No. Civil 146—Phoenix

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE COMPANY,
a corporation,

Defendant.

AMENDED COMPLAINT

Comes now the plaintiff and for her cause of action against the defendant complains and alleges:

I.

That the plaintiff is a resident of Maricopa County, State of Arizona, and that the defendant,

New York Life Insurance Company, is a corporation duly organized and existing under and by virtue of the laws of the State of New York, and now is, and at all times mentioned herein, was duly qualified to do business in the State of Arizona, and to solicit, sell and issue life insurance and life insurance policies therein.

II.

That on December 7, 1939, Zeno A. Rogers, now deceased, made application to the defendant herein for life insurance and a life insurance policy upon his life for the face amount of Two Thousand (\$2000.00) Dollars, with double indemnity features in the event of his accidental death, and with the plaintiff, Lois Rogers, named as beneficiary thereunder, or in the event of her prior death, to Gale A. Rogers and Russel L. Rogers, sons of the insured, share and share alike, or to the survivor.

That said applicant was examined on the same day, and thereafter the said defendant, New York Life Insurance Company, by and through its agents, delivered to Zeno A. Rogers, the applicant, its New York Life Insurance policy #17-507-735, together with the application of said Zeno A. Rogers and his [20] answers to the medical examiner thereto attached.

III.

That on January 26, 1940, the said Zeno A. Rogers was in an automobile accident and as a consequence thereof received injuries, and died on

January 28, 1940, as a result of said accident; that said Zeno A. Rogers died within the State of Arizona and that his death resulted directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental causes, and that such death occurred within sixty days after the sustaining of such injuries.

IV.

That the said Zeno A. Rogers paid the premium for such policy of insurance, and in the making of said application for insurance and receiving delivery of the same from the defendant, New York Life Insurance Company, duly performed all the conditions and agreements of said policy of insurance on his part, and defendant accepted performance thereof, and delivered the policy, and that the said Zeno A. Rogers was in possession of the policy at the time of his death.

V.

That prior to the beginning of this action defendant waived the provisions of said policy regarding proofs of death and proofs of loss, and estopped itself from demanding the submission of said proofs of death and proofs of loss by its repudiation of the aforesaid policy of insurance and by its denial of liability under the terms thereof, and its refusal and failure to furnish or supply plaintiff with the forms of said proof.

VI.

That long prior to the 7th day of December, 1939, and up to and including the 28th day of January, 1940, Zeno A. Rogers, deceased, and plaintiff, Lois Rogers, were husband and wife; [21] that plaintiff as said wife had an insurable interest in the life of said deceased and was specifically named in said policy as beneficiary of the insured.

That the plaintiff has made demand upon the said defendant company for the payment of the death benefits under said policy; that said defendant has failed to pay, and has refused and refuses to pay the said benefits and amounts due.

VII.

That the plaintiff herein is entitled to recover the sum of Two Thousand (\$2000.00) Dollars, the face value of said policy, and the additional sum of Two Thousand (\$2000.00) Dollars being double the amount of the face value of said policy for the accidental death of the insured, which death resulted directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental causes within sixty days after the sustaining of such injuries.

Wherefore, plaintiff prays judgment against the

defendant for the sum of Four Thousand (\$4000.00) Dollars and for her costs herein incurred.

JOHN FRANCIS CONNOR

626 Heard Building,

Phoenix, Arizona.

C. H. YOUNG

209 Luhrs Building,

Phoenix, Arizona.

Attorneys for Plaintiff

Received copy of the foregoing amended complaint this 3rd day of December, 1940.

ELLINWOOD & ROSS

Attorneys for Defendant

[Endorsed]: Filed Dec. 3, 1940. Edward W. Scruggs, Clerk United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [22]

[Title of District Court and Cause.]

ANSWER TO PLAINTIFF'S
AMENDED COMPLAINT

Comes now the defendant and for answer to plaintiff's Amended Complaint admits, denies and alleges as follows:

I.

Admits all of the allegations contained in Paragraphs I, II, III and VI of Plaintiff's Amended Complaint, except the allegation contained in Paragraph II thereof that defendant delivered to Zeno

A. Rogers its insurance policy No. 17507735 together with the application and his answers to the medical examiner. Said allegation defendant expressly denies.

II.

Denies all of the allegations contained in Paragraph IV of Plaintiff's Amended Complaint except the allegation that the policy referred to therein was in the possession of Zeno A. Rogers at the time of his death.

III.

Denies all of the allegations contained in Paragraphs V and VII of Plaintiff's Amended Complaint.

IV.

Alleges that on December 7, 1939, Zeno A. Rogers made an application to defendant for a policy of insurance in the amount of \$2,000 on the Ordinary Life Plan with disability and double indemnity benefits; that said application provided, among [23] other things, that the insurance applied for should not go into force unless and until the policy was delivered to and received by the applicant and the first premium thereon paid in full during his lifetime; that on December 19, 1939, the Head Office of defendant, located in New York, N. Y., issued its policy No. 17-507-735 on the life of Zeno A. Rogers in the amount of \$2,000, with disability and double indemnity benefits on the Ordinary Life Plan; that said policy was not issued as applied for in the aforesaid application; that the said policy

differed from the policy applied for in that defendant endorsed thereon a rider clause modifying its liability in the event of the death of the insured while riding in or operating an aircraft; that the Head Office of defendant mailed said policy to the Arizona Branch Office of defendant on December 19, 1939, with the instruction that it was not to be delivered to Zeno A. Rogers until the first semi-annual premium thereon, in the sum of \$40.50, was paid and said applicant had signed an agreement accepting the policy as modified by the aforesaid aviation endorsement; that on December 29, 1939, said policy was, through inadvertence and mistake, and contrary to the aforesaid instruction, forwarded to Zeno A. Rogers by mail without defendant's first having collected the initial premium thereon and without having obtained the signature of said Zeno A. Rogers to the agreement accepting the policy as modified by the aviation endorsement thereon; that defendant notified Zeno A. Rogers that the aforesaid policy had been forwarded to him in error and requested him to return said policy to defendant until the first premium was paid; that Zeno A. Rogers did not return the aforesaid policy to defendant and did not pay the said premium and did not execute the agreement accepting the policy as modified. [24]

Wherefore, defendant prays that plaintiff take nothing by her Amended Complaint and that de-

fendant recover its costs expended and incurred herein.

ELLINWOOD & ROSS
JOS. S. JENCKES, JR.
EVERETT M. ROSS

Attorneys for Defendant
807 Title & Trust Bldg.
Phoenix, Arizona

State of Arizona,
County of Maricopa—ss.

David F. Caskey, being first duly sworn on oath, deposes and says: That he is Cashier of the Arizona Branch Office of New York Life Insurance Company, a corporation, defendant in the above action, and that as such Cashier he is duly authorized to make this verification for and on behalf of said defendant; that he has read the foregoing Answer and knows the contents thereof and that the same is true in substance and effect.

DAVID F. CASKEY

Subscribed and sworn to before me this 12th day of December, 1940.

[Seal]

LUCILLE HILL
Notary Public

My commission expires: 3/17/41.

[Endorsed]: Filed Dec. 12, 1940. Edward W. Scruggs, Clerk United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [25]

[Title of District Court.]

October 1940 Term

At Phoenix

MINUTE ENTRY OF
MONDAY, MARCH 10, 1941
(Phoenix Division)

Honorable Dave W. Ling, United States Judge,
Presiding.

[Title of Cause.]

Plaintiff's Motion to Set comes on regularly for hearing this day.

John Francis Connor, Esquire, appears as counsel for plaintiff and Everett Ross, Esquire, appears as counsel for the defendant.

It is ordered that this case be set for trial April 22, 1941, at ten o'clock a. m. [26]

[Title of District Court and Cause.]

INSTRUCTIONS FOR JURY
INSTRUCTIONS FOR JURY REQUESTED
BY PLAINTIFF [27]

I.

You are instructed, that if you believe from the evidence that prior to and up to and including the date of delivery of the life insurance policy sued on herein, the New York Life Insurance Company voluntarily and knowingly held Arthur F. Lindberg David F. Caskey out to the world as its Agency

Director for the State of Arizona, and as authorized to supervise, direct and control the said company's life insurance business within said State of Arizona, and to permit, authorize or direct the delivery of life insurance policies similar to the one herein involved without the pre-payment of the first premium, or any premium thereon, and had so conducted itself in this regard, as to reasonably justify the public generally, and those dealing with it, in believing that the said Arthur F. Lindberg was authorized, permitted or directed to deliver, permit or cause to be delivered similar policies, and that the policy herein involved was received and accepted by the said Zeno A. Rogers, believing that the said Arthur F. Lindberg had authority to so deliver said policy without the pre-payment of premium, then the New York Life Insurance Company, in the absence of some reason or cause deemed sufficient in law, would be bound by the acts of the said Arthur F. Lindberg.

Branson Inst. To Juries 182;

Fore v. Hitson, 8 S. W. 292

Smith v. Wise, 58 Ill. 141;

Haskell v. Starbird, 25 N. E. 14.

Given.

DAVE W. LING [28]

II.

You are instructed that either by contract or by operation of law, the said Arthur F. Lindberg, as Agency Director, the said David F. Caskey, as Agency Cashier for the State of Arizona; and/or

any other persons employed in said Agency office, charged with the duty of handling, controlling, mailing or delivery of insurance policies within the scope of their employment, are regarded as agents of the defendant company; and you are further instructed that such persons as agents could bind the defendant company within the limits of the authority with which they, or any of them, apparently were clothed, in respect to the subject matter of his agency, and for the protection of innocent third persons.

The authority of an agent is enlarged by implication when the principal permits the agent to do acts not expressly authorized, and if, through inattention or otherwise, the defendant company suffered its agents, or any of them, to act beyond his, or their, authority without objection, then the company, in the absence of some reason or cause deemed sufficient in law, is bound to those who were not aware of any want of authority, to the same extent as if the requisite power had been directly conferred.

* * * * *

Branson Inst. to Juries 182;

Hanover Nat'l Bank v. Amer. Dock Co., 43
N. E. 72, 51 Amer. State 721;

Ins. Co. v. Norton, 96 U. S. 234;

Manufacturers etc. Co. v. Armstrong, 45 Ill.
App. 217;

U. S. Life Ins. Co. v. Lesser, 28 So. Reps.
646.

Given.

DAVE W. LING [29]

III.

You are instructed, that if you find from the evidence that the policy sued on herein was mailed to, and received by the said Zeno A. Rogers previous to the time of his death, or that said policy was found among the papers of the said Zeno A. Rogers after his death, and that said policy acknowledged the payment of the first premium, then such delivery, possession and acknowledgment constitute prima facie evidence of a binding contract of insurance, and the burden of proof falls upon the defendant company to establish, by evidence, some reason regarded by the law as good and sufficient, why the plaintiff should not recover judgment in this action.

Abbott Tr. Ev. Vol. 2. 1242.

Page v. Virginia Life Ins. Co. 42 SE 543

Rayburn v. Pa. Cas. Co. 50 SE 762, 107 Am.
St. Rep. 548

Home Ins. Co. v. Gilman et al 112 Ind. 7

De Frece v. Nat'l Life Ins. Co. 32 NE 556

Pointer v. Ind. Life et al 30 NE 876

Michigan Mut. Life Ins. Co. v. Custer 128
Ind. 255, 46 At. 1005

Mauck v. Merchants etc. 54 At. 952

Washburn v. Union Cent. Life Ins. Co. 30 So.
Reps. 1011

Given.

DAVE W. LING. [30]

IV.

You are instructed, that the application for life insurance policy signed by Zeno A. Rogers and said life insurance policy issued in connection therewith are to be construed together, and if you find from the evidence that the said Zeno A. Rogers, in his executed application, waived all benefits of his insurance policy in case of an accident in connection with aircraft, then you are instructed that the signature of Zeno A. Rogers to the so-called permanent aviation clause proposed for his further signature, was not essential to constitute an enforceable life insurance contract; and if you find all other necessary facts in favor of the plaintiff, you are instructed that the plaintiff is entitled to recover in this action, notwithstanding any such failure, if such you find, on the part of Zeno A. Rogers to sign said permanent aviation clause previously to the delivery to him of said insurance policy.

Given.

DAVE W. LING. [31]

VI.

You are instructed that if you find from the evidence that at any time previous to the death of Zeno A. Rogers, the Defendant acting in this behalf by its proper authorized officers agreed expressly or by implication that Zeno A. Rogers might pay the first premium due on the policy herein involved,

out of his commissions or future earnings, then you are further instructed that such an agreement could not be rescinded or terminated by the Defendant after the death of the said Zeno A. Rogers without the consent of Mrs. Rogers, the beneficiary, named in the policy.

Given.

DAVE W. LING.

[Endorsed]: Filed Apr 23 1941 Edward W. Scruggs, Clerk, United States District Court for the District of Arizona By Gwen J. Ballard, Deputy Clerk. [32]

[Title of District Court and Cause.]

Defendant's Requested Instruction No. 1

The Court instructs you that an insurance policy may be issued and signed by the defendant company and still be inoperative for want of delivery, for the application signed by Rogers provided that the insurance should not go into effect unless and until the policy was delivered. The question of delivery is always one of intention. Consequently, if you find that the defendant company forwarded the policy to Zeno A. Rogers by mistake and without the intention of parting with possession of it; then there was no delivery of the policy and your verdict must be for defendant.

29 Am. Jur. p. 164

Given.

DAVE W. LING. [33]

[Title of District Court and Cause.]

Defendant's Requested Instruction No. 2

It is provided in the application which Zeno A. Rogers made for the insurance policy in question that the insurance applied for should not go into effect until the first premium was paid in full during the insured's lifetime. The burden of proof is upon the plaintiff to satisfy you by a preponderance of the evidence that Zeno A. Rogers paid the first premium to defendant. Then your verdict must be for the defendant unless you find that credit for said premium was extended to Zeno A. Rogers by Lindberg while acting within the scope of his employment.

Curtis v. Prudential Ins. Co. (C.C.A.4th,
1932) 55 Fed. (2d) 97

Given:

DAVE W. LING.

[Endorsed]: Filed Apr 23 1941 Edward W. Scruggs, Clerk United States District Court for the District of Arizona By Gwen J. Ballard, Deputy Clerk. [34]

[Title of District Court.]

April 1941 Term

At Phoenix

MINUTE ENTRY OF
WEDNESDAY, APRIL 23, 1941
(Phoenix Division)

Honorable Dave W. Ling, United States District
Judge, Presiding

[Title of Cause.]

The Jury, and all members thereof, the parties
and counsel are present pursuant to recess, and fur-
ther proceedings of trial are had as follows:

Rebuttal Continued:

Stanley Clem is now sworn and examined on be-
half of the plaintiff.

Plaintiff's Exhibit 5, Letter dated October 30,
1939, from Z. A. Rogers to the New York Life In-
surance Co., is now admitted in evidence.

The plaintiff, Lois Rogers, heretofore sworn, is
now recalled and further examined in her own be-
half.

Gail Rogers, heretofore sworn, is now called and
examined on behalf of the plaintiff.

The plaintiff, Lois Rogers, heretofore sworn, is
now recalled and further examined in her own be-
half.

Thereupon, the Plaintiff rests.

Surrebuttal:

Arthur F. Lindberg, heretofore sworn, is now
recalled and further examined on behalf of the
defendant.

And the Defendant rests.

Both sides rest.

Thereupon, at the hour of 11:25 o'clock a.m., the Jury, being first duly admonished by the Court, is excluded from the Courtroom.

Counsel for the defendant now moves for a directed verdict on the grounds that there has been no evidence that any premium has been paid on the policy in question or that there was any waiver of a premium; that there is [35] no evidence that the policy was delivered; and that it has been shown by the evidence that there is no authority on the part of Mr. Lindberg, or any other agent in Arizona, to waive the payment in cash or the premium due on this policy, and also Mr. Rogers was advised of the limitations of the Agents' authority.

Whereupon, the Jury and all members thereof return into open Court at the hour of 11:45 o'clock a. m., and

It is ordered that said motion for a directed verdict be and it is denied.

And thereupon, at the hour of 11:46 o'clock a. m., it is ordered that the further trial of this case be continued to the hour of 2:15 o'clock p.m., to which time the Jury, being first duly admonished by the Court, the parties and counsel are excused.

Subsequently, at the hour of 2:15 o'clock p.m., the Jury and all members thereof, the parties and respective counsel being present pursuant to recess, further proceedings of trial are had as follows:

All the evidence being in, the case is argued by

respective counsel to the Jury. Whereupon, the Court duly instructs the Jury and said Jury retire at the hour of 3:35 o'clock p.m., in charge of a sworn bailiff to consider of their verdict.

Subsequently, the parties and counsel being present, the Jury return in a body into open Court at the hour of 5:40 o'clock p.m., and all members thereof being present, through their foreman request that the Court's instructions be read to them, and such instructions are now read to the Jury by Louis L. Billar, reporter, and said Jury retire at the hour of 5:50 o'clock p.m., in charge of a sworn bailiff to further consider of their verdict.

Subsequently, the parties and counsel being present, the Jury return in a body into open Court at the hour of 6:00 o'clock p.m., and all [36] members thereof being present, are asked if they have agreed upon a verdict. Whereupon, the Foreman reports that they have agreed and presents the following verdict, to-wit:

CIV-146 Phoenix

“LOIS ROGERS

Plaintiff

Against

NEW YORK LIFE INSURANCE

COMPANY, a corporation

Defendant

VERDICT

We, the Jury, duly empaneled and sworn
in the above entitled action, upon our
oaths, do find for the plaintiff.

HARRY H. DAVIS,

Foreman.”

The verdict is read as recorded and the Jury is
discharged from the further consideration of this
case and excused until Thursday, May 1, 1941, at
ten o'clock a.m. [37]

In the District Court of the United States
For the District of Arizona

No. Civil 146—Phoenix

LOIS ROGERS,

Plaintiff,

vs.

NEW YORK LIFE INSURANCE
COMPANY, a Corporation,

Defendant.

JUDGMENT

The above entitled cause came on regularly for trial on the 22nd day of April, before the Honorable Dave W. Ling, presiding with a jury, the plaintiff appearing in person and by her attorneys, Dougherty and Chandler, and John Francis Connor, and the defendant appearing by Arthur F. Lindberg, Agency Director, of the Arizona Branch office for defendant, and its attorneys **Everett M. Ross** and **Joseph S. Jenckes, Jr.**, of Ellinwood and Ross; a jury was duly empaneled and sworn to well and truly try the issues in said cause; the taking of testimony was thereupon commenced and concluded on the 23rd day of April, 1941, whereupon both sides rested.

The defendant then moved the Court to instruct a verdict in its favor and the said motion was duly argued, submitted and denied. The cause was orally argued before the jury by counsel for the respective parties and thereafter the Court duly in-

structed the jury as to the law and the jury then retired to deliberate on its verdict and on the same date did return into [59] open Court its verdict in said cause as follows:

“We the jury, duly empaneled and sworn in the above entitled action, upon our oaths do find for the plaintiff

HARRY H. DAVIS

Foreman

It is therefore, ordered, adjudged and decreed, that the plaintiff Lois Rogers, do have and recover judgment of and from the defendant, New York Life Insurance Company, a Corporation, in the sum of Four Thousand (\$4,000.00) Dollars, with interest thereon at six (6%) per cent from the 1st day of February, 1940, until paid, less the sum of Forty (\$40.50) Dollars and Fifty Cents, semi-annual premium payment accruing on the policy sued on herein; together with her costs and disbursements incurred by reason of this action, taxed and allowed in the sum of \$82.70.

Dated this 2nd day of May, A.D., 1941.

Approved as to form:

Ellinwood and Ross

Attorneys for Defendant

By JOS. S. JENCKES, JR.

[Endorsed]: J. D. Filed May 2 1941 Edward W. Scruggs, Clerk United States District Court for the District of Arizona by Gwen J. Ballard, Deputy Clerk. [60]

[Title of District Court and Cause.]

MOTION TO ENTER JUDGMENT IN AC-
CORDANCE WITH DEFENDANT'S MO-
TION FOR AN INSTRUCTED VERDICT,
AND MOTION FOR NEW TRIAL

Comes now the defendant and moves the Court for an order setting aside the verdict and judgment herein and entering judgment in accordance with defendant's motion for a directed verdict. In the event the aforesaid motion is denied, defendant moves the Court for an order granting a new trial of the above-entitled cause for the following reasons, to-wit:

1. The Court erred in refusing to instruct the jury to return a verdict for defendant;
2. The Court erred in certain particulars in its general charge to the jury, specifically excepted to by the defendant at the time.
3. The verdict and judgment are not justified by the evidence.
4. The verdict and judgment are contrary to law.

ELLINWOOD & ROSS
JOS. S. JENCKES, JR.
EVERETT M. ROSS [61]

[Title of District Court and Cause.]

MEMORANDUM OF POINTS
AND AUTHORITIES

In support of its motion for an order setting aside the verdict and judgment and entering judgment in accordance with defendant's motion for a directed verdict, defendant submits the following points and authorities:

I.

It Was Essential to the Existence of a Binding Contract of Insurance That the Policy in Question Be Delivered to Applicant. At the Trial of the Cause There Was No Evidence Whatever Showing That the Policy Was Delivered to Zeno A. Rogers.

*

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II.

Aside from the Question of Delivery, There Could Be No Binding Contract Until Rogers Signed the Agreement Accepting the Policy as Modified.

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III.

There Was No Evidence Either That the First Premium Was Paid in Cash, or That the Payment of Such Premium in Cash Was Waived by a Duly Authorized Agent of Defendant.

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*

(a) The Court erred in giving plaintiff's instruction [62] No. 1.

* * * *

(b) The Court erred in giving plaintiff's instruction No. 2.

* * * *

(c) The Court erred in giving plaintiff's instruction No. 3.

* * * *

(d) The Court erred in giving plaintiff's instruction No. 4.

* * * *

(e) The Court erred in giving plaintiff's instruction No. 6.

* * * *

[Endorsed]: Filed May 3, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [63]

[Title of District Court.]

MINUTE ENTRY OF
SATURDAY, JUNE 28, 1941
(Phoenix Division)

April 1941 Term

At Phoenix

Honorable Dave W. Ling, United States District
Judge, Presiding.

[Title of Cause.]

It Is Ordered that Defendant's Motion to set aside the verdict and judgment herein and enter

judgment in accordance with defendant's motion for a directed verdict be and it is denied.

It Is Further Ordered that Defendant's Motion for a New Trial be and it is denied. [64]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE CIRCUIT
COURT OF APPEALS

To Lois Rogers, and her attorneys, John Francis
Connor and Dougherty & Chandler:

Notice is hereby given that New York Life Insurance Company, the defendant above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on the 23rd day of April, 1941.

ELLINWOOD & ROSS

EVERETT M. ROSS

Attorneys for Appellant

807 Title & Trust Bldg.

Phoenix, Arizona

[Endorsed]: Filed Jul. 10, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [65]

[Title of District Court and Cause.]

STIPULATION WAIVING
BOND ON APPEAL

It Is Hereby Stipulated and Agreed by and between plaintiff and defendant, through their respective counsel of record, that the giving of a bond for costs on appeal to the Circuit Court of Appeals of the Ninth Circuit from the judgment entered herein on the 23rd day of April, 1941, in favor of plaintiff and against defendant, as required by Rule 73 of Rules of Civil Procedure for the District Courts of the United States, is hereby waived, and said appeal shall be prosecuted as if a bond in due form had been filed as of the date of filing this stipulation.

It Is Further Stipulated that, pending the disposition of said appeal by the Circuit Court of Appeals of the Ninth Circuit, plaintiff shall not have execution issued on said judgment.

Dated this 9th day of July, 1941.

DOUGHERTY & CHANDLER

Attorneys for Plaintiff

ELLINWOOD & ROSS

EVERETT M. ROSS

Attorneys for Defendant

[Endorsed]: Filed Jul. 10, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [66]

[Title of District Court and Cause.]

STATEMENT BY DEFENDANT AND APPELLANT OF POINTS UPON WHICH IT INTENDS TO RELY ON APPEAL

Comes now New York Life Insurance Company, the appellant and defendant above named, by its attorneys Ellinwood & Ross, Jos. S. Jenckes, Jr. and Everett M. Ross, and states that the following is a concise statement of the points on which it intends to rely on the appeal of the above-entitled action to the United States Circuit Court of Appeals for the Ninth Circuit:

I.

The Court erred in denying defendant's motion at the close of all the evidence to instruct the jury to return a verdict for defendant. Said motion should have been granted for the following reasons: (a) It was essential to the existence of a binding contract of insurance that the policy in question be delivered to applicant. At the trial of the cause there was no evidence that the policy was so delivered. (b) There could be no binding contract of insurance until the applicant signed the agreement accepting the policy as modified. (c) There was no evidence either that the first premium was paid in cash, or the payment of such premium in cash was waived by a duly authorized agent of defendant.

II.

The Court erred in certain particulars of its general charge to the jury, namely, in giving plaintiff's instructions No. 1, 2, 3, 4, and 6. The defendant specifically excepted to said instructions at the time and set forth the grounds for said objections.

III.

The verdict and judgment were not justified by the evidence and were contrary to law in that there was no evidence that there was a binding contract of insurance in existence.

Dated: July 17, 1941.

ELLINWOOD & ROSS

JOS. S. JENCKES, JR.

By E. M. R.

EVERETT M. ROSS

Attorneys for defendant

Received a copy of the within Statement by Defendant and Appellant of Points Upon Which It Intends to Rely on Appeal this 17th day of July, 1941.

DOUGHERTY & CHANDLER

Attorney for Plaintiff

[Endorsed]: Filed Jul. 17, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Gwen. J. Ballard, Deputy Clerk. [68]

[Title of District Court and Cause.]

DEFENDANT AND APPELLANT'S DESIGNATION OF CONTENTS OF RECORD
ON APPEAL

To the Clerk of the District Court of the United States of America in and for the District of Arizona:

You are hereby requested to make a record to be filed in the United States Court of Appeals for the Ninth Circuit pursuant to an appeal taken in the above-entitled action, and to include in such record on appeal the following portions of the record, proceedings and evidence of the above-entitled case:

1. Summons and return.
2. Complaint.
3. Petition for removal.
4. Removal bond
5. Notice of filing of and hearing on petition for removal
6. Affidavit of service of notice
7. Order for removal
2. Amended complaint
9. Amended answer
10. Order setting cause for trial on April 22, 1941
11. Order denying defendant's motion for instructed verdict
12. Verdict
13. Judgment

14 Defendant's motion to enter judgment in accordance with defendant's motion for an instructed verdict and motion for new trial.

(a) The first paragraph and the italicized captions heading parts I, II, III and a, b, c, d, and e of the memorandum of points and authorities filed in support of said motions. [69]

15. Order denying defendant's motion to enter judgment in accordance with defendant's motion for an instructed verdict and order denying defendant's motion for new trial.

16. Notice of appeal.

17. Stipulation waiving bond on appeal.

18. Duplicate reporter's transcript of the evidence.

19. The following portions of plaintiff's Exhibit No. 3:

(a) All of the insurance policy with the exception of the following parts:

(1) The paragraph entitled "Double Indemnity"

(2) The paragraph entitled "Waiver of Premiums in Event of Total and Permanent Disability"

(3) The paragraph entitled "Participation in Surplus"

(4) The paragraph entitled "Dividends may be applied to decrease number of premium payments"

(5) The paragraph entitled "Miscellaneous Benefits"

- (6) The page entitled "Optional Methods of Settlement"
 - (7) The page entitled "Guaranteed Loan and Surrender Values"
 - (8) The page entitled "Tables of Guaranteed Loan and Surrender Values"
 - (9) The page entitled "Other Provisions" with the exception of the paragraph entitled "The Contract". Said paragraph is to be included in the record on appeal.
 - (b) All of the "Permanent Aviation Indorsement" attached to the policy.
 - (c) All of the "Acceptance of the Permanent Aviation Indorsement" attached to the policy
 - (d) Part I of the Application which is attached to the policy
 - (e) All of the Questionnaire pertaining to aeronautical activities.
20. Defendant's Exhibit C-1
21. Defendant's Exhibit E (the salutation, the fourth paragraph and the closing)
22. The following portions of Defendant's Exhibit F:
- (a) The first page, and
 - (b) Instructions No. 1, 2, 20, and the first paragraph of Instruction No. 12.
23. Statement of defendant of points upon which it intends to rely on appeal. [70]

24. Plaintiff's requested instructions No. 1, 2, 3, 4, and 6 as given.

25. This designation of contents of record on appeal.

Dated this 17th day of July, 1941.

ELLINWOOD & ROSS

JOS. S. JENCKES, JR.

By E. M. R.

EVERETT M. ROSS

Attorneys for Defendant

[Endorsed]: Filed Jul 17 1941 Edward W. Scruggs, Clerk, United States District Court for the District of Arizona by Gwen J. Ballard, Deputy Clerk. [71]

[Title of District Court and Cause.]

PLAINTIFF AND APPELLEE'S DESIGNATION OF ADDITIONAL PORTIONS OF RECORD ON APPEAL.

To the Clerk of the District Court of the United States of America, in and for the District of Arizona:

You are hereby requested to make a record to be filed in the United States Court of Appeals for the Ninth Circuit pursuant to an appeal taken by the defendant in the above entitled action, and to include in such record on appeal the following additional portions of the record, proceedings and evidence of the above entitled case:

1. Plaintiff's Exhibit No. 5 (Letter to New York Life Insurance Company, date October 30, 1939, signed by A. Z. Rogers, authorizing payment of \$75.00 to Stanley Clem).

2. Plaintiff's Exhibit No. 1, the following portions of the same:

(a) The Masthead.

(b) Table of "Application Leaders".

(c) Table of "Volume Leaders"

(d) Table of "App.-a-week Club report".

3. Defendant's requested instructions No. 1 and 2, as given.

4. This Designation of Additional Portions of Record on Appeal.

Dated this 22nd day of July, 1941.

JOHN FRANCIS CONNOR

DOUGHERTY & CHANDLER

By M. J. DOUGHERTY

Service of the within instrument acknowledged this 22nd day of July, 1941.

ELLINWOOD & ROSS

By. W. J. RYLEY

[Endorsed]: Filed Jul 23 1941 Edward W. Scruggs, Clerk United States District Court for the District of Arizona by Gwen J. Ballard, Deputy Clerk. [72]

In the United States District Court
for the District of Arizona

United States of America
District of Arizona—ss.

I, Edward W. Scruggs, Clerk of the United States District Court for the District of Arizona, do hereby certify that I am the custodian of the records, papers and files in the case of Lois Rogers versus New York Life Insurance Company, a corporation, number Civ-146 Phoenix, on the docket of said Court.

I further certify that the attached pages numbered 1 to 72, inclusive, contains a full, true and correct transcript of the proceedings of said cause and all the papers filed therein, together with the endorsements of filing thereon, called for and designated in Defendant's and Appellant's Designations of Contents of Record on Appeal and Plaintiff's and Appellee's Designations of Contents, filed in said cause and made a part of the transcript attached hereto, as the same appear from the originals of record and on file in my office as such Clerk, in the City of Phoenix, State and District aforesaid, with the exception of the duplicate original of the reporter's transcript of the evidence, which said duplicate original of the reporter's transcript of the evidence is transmitted herewith to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the Clerk's fee for preparing and certifying to this said transcript of record

amounts to the sum of \$16.95 and said sum has been paid to me by counsel for the appellant.

Witness my hand and the seal of said Court this 8th day of August, 1941.

[Seal]

EDWARD W. SCRUGGS

Clerk [73]

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT

The above entitled and numbered cause came on duly and regularly for trial in the above entitled Court, before Honorable Dave W. Ling, Judge, presiding with a jury, commencing at the hour of ten o'clock A. M. on the 22d day of April, 1941, at Phoenix, Arizona.

The plaintiff was represented by John Francis Connor, Esquire, Phoenix, Arizona, and M. J. Dougherty of Messrs. Dougherty and Chandler, Attorneys at Law, Phoenix, Arizona.

The defendant was represented by its attorneys, Messrs. Ellinwood and Ross, by Everett M. Ross and Joseph S. Jenckes, Jr., Phoenix, Arizona.

Thereupon the following proceedings were had.

[76]

REPORTER'S TRANSCRIPT OF
PROCEEDINGS

The Clerk: Civil 146, Phoenix, Lois Rogers, Plaintiff, vs. New York Life Insurance Company, a corporation, defendant.

The Court: Ready?

Mr. Connor: Ready, your Honor.

Mr. Ross: Ready, your Honor.

The Court: Call the names of eighteen jurors. As your names are called, come forward.

(Thereupon 18 jurors were called, were first duly sworn, and examined on their voir dire by the respective attorneys after which, the following jurors were selected and duly sworn: Phillip W. Ketcham; Nick King; W. H. Zeigler; H. M. Chappel; J. W. Hall; W. L. Jack; Harry H. Davis; C. L. Baldwin; L. L. Hopper; Lee T. Acton; Kay Robinson; Bruce C. Parkinson.)

The Court: You may read your complaint.

Mr. Connor: If your Honor please, I think the plaintiff would like to request that the witnesses be sworn and the rule invoked.

The Court: All right, call the witnesses.

(Thereupon the witnesses were called before the Court, duly sworn, admonished and placed under the rule, and excluded from the court room.)

(Thereupon the Amended Complaint was read to the jury by Mr. Connor, after which the following opening statement was made:) [77]

Mr. Connor: Now, gentlemen, just a short state-

ment of the issues in this case on what we propose to prove.

Mrs. Rogers, of course, the plaintiff, is represented by Mr. Dougherty and myself. The New York Life Insurance Company is being represented by the firm of Messrs. Ellinwood and Ross, represented by Mr. Everett Ross and Mr. Jenckes today. Mrs. Rogers, as the plaintiff, is the surviving wife of Zeno A. Rogers, deceased, who was killed, as the complaint says, as a result of an automobile accident on January 28th, 1940, at or near Fort Huachuca, Arizona, while traveling on the public highway.

We will show that subsequent to his death Mrs. Rogers, the plaintiff herein, made demand for the payment of that policy, and that in addition thereto she sought to comply with the requirement of the company with proofs of loss or proofs of death being furnished to the company and in response thereto the company denied liability under the policy and failed and refused to furnish or to give to her the forms on the proof of loss.

We will show—I will say that we are somewhat at a loss, I don't know exactly why the defendant company, under its premiums, has refused to pay this policy——

The Court: You can argue that after the evidence.

Mr. Connor: Well, that is merely a statement, but if it should be asserted that the deceased or the

insured failed to pay any premiums which were due, then we are prepared to show [78] that the company, through its duly authorized officers, entered into an agreement and arrangements whereby it was agreed that Mr. Rogers was to pay the semi-annual premium out of his commissions and his earnings, to be earned as a successful insurance agent for the New York Life Insurance Company, and if it should further be contended that any waiver or rider was attached to the policy which may have been accepted or signed by Mr. Rogers, then we are prepared to show that the waiver or rider which he was supposed to agree to in order to bind the company, was properly and duly executed by Mr. Rogers.

We are prepared further to show that with respect to the compliance of any condition or performance of any condition required by Mr. Rogers, that with the exception of those waived by the company, he did duly comply with all the requirements demanded by the company, and upon such state of the evidence we will ask that you return a verdict to the plaintiff in the sum of \$4,000.00 because of the death of her husband caused by accidental and solely by external means.

(Thereupon the Answer of the Defendant was read to the jury by Mr. Ross, after which he addressed the jury as follows:)

Mr. Ross: Gentlemen of the jury, now, I realize fully the pleadings where it refers to paragraphs number 1 and 2 and paragraph 5, and so on, but

the pleadings raise two issues for you gentlemen to decide; one, is the question of [79] the payment of the premium and the other is the payment of the policy.

We are prepared to show that Zeno Rogers entered into a contract to write policies for the New York Life Insurance Company on October 28th, 1939; that is, he signed up there with the local office to act as their agent in a certain designated territory.

He commenced at that business seeking applicants and sending in applications for insurance policies.

Now, in December—on December 7th, he applied for a policy on his own life, so as the pleadings disclose, a \$2,000.00 policy which carried double indemnity benefits and it was just on the ordinary life plan. Mrs. Rogers was named as beneficiary. That application was mailed into the Arizona office and forwarded to New York, and on the 19th of December a policy was issued. Now, the policy that was issued was not the same as the policy he had applied for. In other words, his application for a policy disclosed that he had engaged in a certain amount of aviation activities, so the company, in issuing this other policy, attached a rider to it modifying its liability in the event there should be a death through some cause connected with aviation, and in accordance with its usual practice it sent the policy to Arizona with the instructions that

since the policy had been modified, that it should not be delivered to the insured until he had agreed to accept those modifications on that [80] policy.

Now, we intend to show you that the New York Life Insurance Company, I suppose like most insurance companies, do not do a credit business. They do not accept anybody's credit for the first premium. You pay cash for the premium before you get your insurance. Now it is true that if you take out an insurance policy with the company agent, you might not have in mind to pay that premium right at the moment and you may give your note for it. You give your note payable to the agent and that is a transaction entirely between you and the agent. The company has no interest in it and the note is not payable to the company and if the note is not paid, the company does not go after you, they merely collect the money out of the agent's commission, and as far as the company is concerned, it still is a cash transaction. Now, where an agent is the insured, he, obviously, cannot give a note and the company is not going to look to him on his 90-day note, or something like that. It still is a cash transaction—

Mr. Dougherty: We object to that as being argumentative.

The Court: Yes, I think so.

Mr. Ross: And we will show that the company, in such a case, the policy was not to be delivered to the agent until the cash was paid.

We will explain how a policy is handled as they come out of the New York office and forwarded to the Arizona office [81] and to the agents all over the State, and we will show that this policy, through inadvertence, was forwarded to Zeno A. Rogers. We will then show that he, as agent of this company, made a monthly report on the policy which had been sent to him and he disclosed the fact that he was holding this policy. We will show that the company immediately wrote him and advised him of the mistake and told him to return the policy or pay the premium.

We will further show that the company never received any premiums on the policy and that the aviation endorsement which was on the policy was never accepted by the insured.

Thank you.

The Court: Call your first witness.

Mr. Dougherty: Mrs. Rogers.

LOIS ROGERS

was called as a witness in her own behalf and having been heretofore duly sworn testified as follows:

Direct Examination

Mr. Dougherty:

Q. Would you please state your name and place of residence for the record?

A. Lois Rogers, and I reside at 1641 East Roma.

Q. And you are the plaintiff in this case?

(Testimony of Lois Rogers.)

A. I am.

Q. And also the beneficiary in the policy involved in [82] this case?

A. I am.

Q. Who are the members of your family, Mrs. Rogers?

A. My family consists of my two sons, ages 13 and 20, and myself.

Q. Are you acquainted with—strike that out. How long have you lived in Phoenix, Mrs. Rogers?

A. I have lived here two years and a half.

Q. Are you acquainted with Mr. Lindberg, of the New York Life Insurance Company?

A. Yes, sir; I am.

Q. Are you acquainted with any of the members of the office force of that company here in Phoenix?

A. No, I am not. I have met Mr. Caskey.

Q. About October 28th, 1939, where was your husband?

A. About that time he entered the employ of the New York Life Insurance Company as a salesman and agent.

Q. You were living in Phoenix at that time?

A. Yes, we were.

Q. Do you know what territory he was assigned to?

A. Yes, he was assigned to the southern part of the State, which included Willcox, Benson and Bisbee, Fort Huachuca.

Q. The territory in the southern part of the

(Testimony of Lois Rogers.)

State. Now, do you know what his—what was the result of his efforts to sell insurance in that section of the state? [83]

A. Yes, he was—

Q. No, do you know the result of it?

A. Yes, I do.

Q. And how did that information come to you?

A. Through his letters and bulletins that the company issued from time to time.

Q. When you speak of bulletins, do you mean bulletins, announcements or papers from whom?

A. Just small papers announcing the progress of the different salesmen and how they stood.

Q. Yes, from whom?

A. From the New York Life Insurance Company.

Mr. Dougherty: I ask that these be marked for identification.

(Thereupon the documents were received as plaintiff's exhibits 1 and 2 for identification.)

Mr. Dougherty: I hand you Plaintiff's Exhibits 1 and 2 for identification and ask you to state what those are?

Mr. Jenckes: Now, if the Court please, we object to that. I think they speak for themselves.

The Court: Yes.

Mr. Dougherty: Where did you receive them—I will withdraw that question—where did you receive those?

The Witness: I received these through the mail, in letters from my husband.

(Testimony of Lois Rogers.)

Q. They are from the New York Life Insurance Company's office? A. Yes, they are. [84]

Q. At Phoenix?

(No response.)

Q. At Phoenix?

(No response.)

Q. At Phoenix? A. Yes.

Mr. Dougherty: We offer those.

Mr. Jenckes: Let me see them. (Documents were handed to Mr. Jenckes.)

Mr. Ross: We object to these, your Honor. They are immaterial and they haven't any relevancy to the issues in this case.

The Court: Well, let me see them. (The documents were handed to the Court by Mr. Ross.) Well, number 1 might be material. I can't see what number 2 would have to do with this case.

Mr. Dougherty: They are offered for another purpose, to show the employment of Rogers and his successes as an agent.

The Court: Well, this is a personal memorandum of Mr. Rogers and tells what somebody else has done. It didn't have anything to do with him. I will admit number 1. The objection to number 2 is sustained.

(Thereupon the document was received as Plaintiff's Exhibit 1 in evidence.) [85]

(Testimony of Lois Rogers.)

PLAINTIFF'S EXHIBIT NO. 1

THE ARIZONA BRANCH

WEEKLY BULLETIN

Printed Every Tuesday

Sales Records for Last Week

Application Leaders

Volume Leaders

Z. A. Rogers.....	71½
Van B. Brinton.....	7
D. K. Pence.....	6
W. L. Bowers.....	51½
E. W. Bradford.....	4
J. J. McGoey.....	4
W. M. Vreeland.....	3
Alice F. Abbott.....	3
Bill E. Christian.....	3
Jeanette Steinberg	2
Wm. P. Hanson.....	2
Gertrude D. Hays.....	2
George R. White.....	2

W. L. Bowers.....	\$20,200
Van B. Brinton.....	17,500
E. W. Bradford.....	10,500
Z. A. Rogers.....	10,087
Jeanette Steinberg.....	7,500
D. K. Pence.....	7,000
J. J. McGoey.....	6,000
W. M. Vreeland.....	6,000
Guy A. Ligon.....	4,040
Alice F. Abbott.....	4,000
Bill E. Christian.....	3,000
Wm. P. Hanson.....	3,000
George R. White.....	3,000

(Testimony of Lois Rogers.)

APP-A-Week Club Report :

Name	Consec. Wks.	Location
Max A. Dunlap.....	327	Phoenix
Wm. P. Hanson.....	277	Douglas
W. L. Bowers.....	223	Tucson
Ellen A. Copper.....	194	Phoenix
Gertrude Hays.....	194	Phoenix
J. J. McGoey.....	174	Miami
W. M. Vreeland.....	160	Tucson
E. W. Bradford.....	81	Tucson
George White.....	52	Tucson
D. K. Pence.....	50	Warren
C. C. Cutler.....	42	Clifton
G. S. Wallace.....	39	Phoenix
Z. A. Rogers.....	9	Willcox
L. K. Murphy.....	8	Yuma
Alice Abbott.....	5	Nogales
J. D. Jones.....	4	Phoenix
Kenneth Coffin.....	3	Jerome
Bill Christian.....	3	Willcox
Grover Cole.....	2	Phoenix
Guy A. Ligon.....	2	Phoenix
Ada McLaughlin.....	2	Ajo

[38]

[Endorsed]: Pltfs. Exhibit No. 1. Lois Rogers vs. N. Y. Life Ins. Co. Case No. Civ-146 Phx. Marked for identification April 22, 1941. Admitted and filed April 22, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Wm. H. Loveless, Chief Deputy Clerk. [39]

(Testimony of Lois Rogers.)

Mr. Dougherty: This is a rather lengthy document and unless counsel for the defendant wants to read the entire document, we will only read the part that we consider relevant or pertinent.

The Court: All right.

Mr. Connor: (Addressing the jury) Gentlemen of the jury, this is the article which has been admitted in evidence as Plaintiff's Exhibit No. 1, and it is a weekly bulletin put out by the Arizona branch office of the New York Life Insurance Company. It shows the salesmen record for the last week preceding the date of its issuance and it is a sort-of sales bulletin indicating the leaders in the field among the agents who are selling policies of insurance, and it indicates as of the date of the issuance of this bulletin, that Z. A. Rogers was among the leaders who obtained applications for new policies, and I pass it on to you (handing the document to the jury).

Mr. Dougherty: Shall I proceed?

The Court: Well, probably they can't read that while you are.

Mr. Dougherty: With the permission of the Court, I simply want to point out the relative location of Zeno Rogers' name as one of the agents. The whole matter is not necessary to read, as I understand.

(Thereupon a brief period intervened in which the jurors perused Plaintiff's Exhibit No. 1 in evidence.) [86]

(Testimony of Lois Rogers.)

The Court: We will have a brief recess at this time, gentlemen. During the recess, you will not discuss the case among yourselves or permit anyone to discuss it with you. Also avoid forming or expressing any opinion upon any subject connected with it.

(Thereupon a short recess was taken, after which all parties as noted by the Clerk's record being present, the trial resumed as follows:)

LOIS ROGERS

resumed the witness stand and testified further as follows:

Direct Examination

(Resumed)

Mr. Dougherty:

Q. Your husband remained in the employ of this company from October 28th, 1939, until the time of his death, did he? A. Yes, he did.

Q. Now, during that time did you have any conversations with your husband concerning his policy?

A. Yes, I did.

Q. And concerning this policy which you are suing on now? A. Yes, sir.

Q. And about when was that?

A. At Christmas time.

(Testimony of Lois Rogers.)

Q. Where?

A. At our home in Phoenix when he came home for [87] Christmas.

Mr. Ross: Your Honor, we object to any testimony relative to her conversations with the deceased husband as purely hearsay and self-serving.

Mr. Dougherty: Our contention, your Honor, and on which we are prepared to present authorities, is, that conversations of this kind concerning a specific policy is a part of the *res gestae* and is admissible. We have abundant authorities on that point, to show that communications concerning a policy made at or about the time of its delivery was a part of the *res gestae*. We think that this is admissible.

Mr. Connor: We have a case before us, your Honor, touching upon a fact situation somewhat analogous to the fact situation in this case, where there were statements made by the deceased at or about the time as in the immediate proximity to the date of the delivery of the policy and its acceptance, and the Court allowed the conversations between the deceased and those related to him with reference to what he had to say about his intentions towards that policy as a part of the *res gestae*, and because it did reflect the insured's state of mind with reference to what he thought was the terms of the policy and its delivery and its payment, and I am prepared to hand you cases if you desire to look at them.

(Testimony of Lois Rogers.)

The Court: All right.

Mr. Connor: The case is Hartford vs. Aetna Life Insurance Company, 158 Northwest at Page 280 (Handing citation [88] to the Court).

The Court: (After reading citation) Well, that seems to hold. Have you read the case?

Mr. Ross: No, I have not.

The Court: You probably would have some that held otherwise.

Mr. Ross: If there is any argument on this question, your Honor, I'd like to have it argued in the absence of the jury.

The Court: Well, I say, I suppose you have authorities to the contrary. (Addressing the jury) All right, come back at one-thirty. You will be excused now.

(Thereupon the jury retired from the court room.)

(The witness leaves the witness stand.)

Mr. Dougherty: Now, if your Honor pleases, I might state our position—

The Court: I understand your position. You have one case to support it. Now, what is the general rule? I don't care to hear any argument. I want to know the authorities. I understand your contention.

Mr. Connor: We will grant that there are cases in opposition to this which are to be found—

Mr. Dougherty: Wait a minute, the Court has—
The Court: Has such a question ever been raised in the Federal Courts?

Mr. Connor: I can't, at the moment, say.

Mr. Dougherty: There are a number of cases dealing with [89] the general subject of *res gestae*, which point to the proper application of that rule. I didn't find any insurance case on that point, but I think the rule with respect to the *res gestae* is just as broad in the Federal Court as it is in the State Court.

Mr. Jenckes: If the Court please, I think the issue here might be clarified if the plaintiff would be required to make a tender of proof or an offer of proof at this time. It is rather hard for us to tell just what this testimony is going to be, but certainly, if the testimony is going to be with respect to what the plaintiff's husband told her as to what he did or what was done in connection with this policy, why, the just plain, ordinary, everyday rule of hearsay applies, and—

Mr. Connor: Except to this—excuse me.

Mr. Jenckes: (Continuing) —and, for that reason, so that the Court and we may know just where we stand, why, we request that the Court require them to make an offer of proof so that we may make a proper objection.

The Court: Well that, probably, would be proper and then we would know what we are talking about.

Mr. Dougherty: Well, that is what I was about to explain, your Honor, a minute ago. Does the Court want us to make an offer of proof?

The Court: Yes, you can put Mrs. Rogers on the stand.

Mr. Dougherty: Take the stand, Mrs. Rogers.

[90]

LOIS ROGERS

resumed the witness stand and testified further as follows in the absence of the jury:

Direct Examination (Resumed)

Mr. Dougherty:

Mr. Dougherty: Will you read the last question, Mr. Reporter?

(Thereupon the last question propounded the witness and the answer were read by the Reporter.)

Mr. Dougherty: You stated, Mrs. Rogers, that you had had a conversation with your husband on or about December 23d—between December 23d and the 26th at your home in Phoenix concerning this policy that is being sued on in this case, is that right? A. Yes, we did.

Q. And will you state what that conversation was?

A. He had told the family, me and the two boys, that he had taken out a policy with the company on his own life for \$2,000.00.

(Testimony of Lois Rogers.)

Q. Did he say who the beneficiary was?

A. Yes, he said—he named me as beneficiary with the boys to share and share alike in the event of my death.

Q. Now, was there anything said concerning the payment of the premium? A. Yes, there was.

Q. State what that was? [91]

A. I had told him that he should have waited awhile, that he was just beginning to make good—

Q. You may omit that part, just tell what the conversation was in regard to that; what he said about the payment of the premium?

A. He said that they had made arrangements to pay for the premium, pay the premium out of his earnings as they should accrue.

Q. Who had made arrangements?

A. Mr. Rogers and Mr. Lindberg.

Q. Made arrangements for credit for the payment of the premium? A. Yes, sir.

Q. Is that right? A. Yes, sir.

Q. Just what did he say on that matter?

A. He said, “You needn’t worry about the payment on this because Mr. Lindberg and I have made credit arrangements whereby I will pay the premium out of my earnings as they accrue”.

Q. Do you know whether your husband had previously made any provisions regarding the payment of his premium to others? A. Yes.

Q. With whom—to whom? Had he provided to pay any other debt out of the premium? [92]

(Testimony of Lois Rogers.)

A. He had.

Q. With whom? A. With Mr. Clem.

Q. What was said concerning that?

A. He said that Mr. Clem would agree to wait for his payment until the premium on this policy had been paid.

Q. Did he tell you whether he then had the policy? A. Yes.

Q. He had it in his possession?

A. Yes, he had the policy.

Mr. Dougherty: That, substantially, your Honor, is what our proof would be. We expect to support that by corroborating testimony, by the testimony of other witnesses.

The Court: That is the son?

Mr. Dougherty: No, Mr. Clem, who had the conversation with Mr. Lindberg concerning the very same thing. To tell the Court just what it is, when Mr. Rogers went to work for the company, in order to support his family he borrowed some money from a man named Clem and he agreed to repay Clem out of his earnings, and when he took out this policy, Clem waived the payment of his debt until after the policy premium was paid to the New York Life.

Mr. Jenkes: Now, if your Honor please, we wish to interpose an objection to all that line of testimony on the grounds, in the first place, it is immaterial and has no bearing on the case; that is, the fact that Mr. Rogers told his [93] wife these

(Testimony of Lois Rogers.)

things is wholly irrelevant, immaterial. In other words, if they are attempting to prove merely that he said those things, then that he said them does not have any bearing on the case.

The Court: No.

Mr. Jenckes: Now, if they are attempting to prove the truth of the things that were said by Mr. Rogers, then you run smack against the hearsay rule. We haven't had the time to digest the case, but I think it mentioned in there his state of mind, and so forth. Of course, the only way you can prove the state of mind is, what he said. That is not what they are attempting to prove. They are attempting to prove, I assume, that credit arrangements were made for the taking care of this policy. It is wholly incompetent. As far as the *res gestae* rule is concerned, *res gestae*, as I understand it, ordinarily is where a person spontaneously makes some statement and because he has made it, under those circumstances why the rule does ordinarily require—

Mr. Connor: That is only one.

Mr. Jenckes: That is one, but I can't see any basis here for permitting this sort of testimony to go in. Otherwise, the whole case is proved right out of the mouth of Mrs. Rogers.

Mr. Dougherty: No, that is not our contention. We expect to show during the progress of this case, that not only was this policy, despite the fact that there is a [94] provision in this policy that it should not be delivered until the premium is paid, that that

(Testimony of Lois Rogers.)

is not the practice of the company at all, but despite that fact, the customary practice of the company is to deliver these policies, and to deliver them on credit and there was no exception made in this case whatever. It was in the normal course of their business that they delivered this policy and delivered it on credit. Not only that, we expect to show that when Mr. Rogers came home in response to an inquiry from his wife, he stated he had the policy, she was the beneficiary of it. That is as spontaneous as any declaration could possibly be. It was not a question of credit solely. It was a question of having some protection for his wife and is entirely spontaneous and shows his state of mind. He believed he had arranged for their protection in case of his death. It is just as spontaneous as this case was or any case could be.

(Thereupon argument between counsel.)

Mr. Dougherty: May I ask the witness one question?

The Court: All right.

Mr. Dougherty: You started to tell me what you said and I interrupted you. Will you state how you came to talk about it, in response to your conversation that you had initiated, how did you come to talk about this?

The Witness: About this particular policy?

Q. Yes? You said you had asked him something and I interrupted your conversation? [95]

A. Well, I had asked him why he didn't wait

(Testimony of Lois Rogers.)

awhile to take out the insurance for himself, wait until he was doing a little better. I said, "You are just beginning to make some headway and you should have waited. We can't afford to pay for it now", and he said, "Don't worry about that, I have made arrangements—Mr. Lindberg and I have made arrangements that I can pay this premium out of my commissions as they accrue".

Q. And was there anything said concerning what was due to Mr. Clem? A. Yes, there was.

Q. I don't recall whether you stated that. What did he say with reference to Clem waiting?

A. I said, "Well, you know you owe Mr. Clem this money and you have agreed with Mr. Clem and Mr. Lindberg to pay him out of your earnings", and he said, "Well, that is true, but Mr. Clem will wait for his until my premium is paid".

Mr. Dougherty: I believe that is all.

(Thereupon a recess was taken at 11:45 o'clock A. M.)

1:30 o'clock P. M., April 22d, 1941, all parties as heretofore noted by the Clerk's record, and the jury being present, the trial resumed as follows:

The Court: You may proceed.

Mr. Dougherty: Mrs. Rogers was on the stand.

LOIS ROGERS

resumed the witness stand and testified further as follows:

Mr. Dougherty: I believe when we recessed we had an offer made.

The Court: Yes, and you object to the proffered testimony?

Mr. Jenckes: Yes, if your Honor please, we renew that objection at this time.

The Court: The objection is sustained.

Direct Examination
(Resumed)

Mr. Dougherty:

Q. Is your husband living, Mrs. Rogers?

A. No, he is not.

Q. Where and when did he die?

A. He died January 28th, 1940, at Fort Huachuca Hospital.

Q. And what was the cause of his death?

A. He died as a result of an automobile accident causing cerebral contusions.

Q. A little louder?

A. Cerebral contusions, a broken leg, broken arm, skull fracture and shock.

Q. The accident occurred close to Fort Huachuca?

A. Yes, at the entrance of Fort Huachuca, on the [97] highway.

Q. And where was he taken?

(Testimony of Lois Rogers.)

A. He was taken to the hospital in Fort Huachuca.

Q. And that was when, what date?

A. That was January 26th, the evening of January 26th.

Q. And when did he pass away?

A. He died January 28th.

Q. About what time?

A. At 5:15 in the morning.

Q. Now, where had he been staying previous to this accident?

A. He had been in Willcox, Arizona, at the Page Hotel.

Q. And where did he have his effects at that time? A. In his hotel room at Willcox.

Q. Page Hotel? A. At the Page Hotel.

Q. Now, do you have the insurance policy that is sued on in this case, Mrs. Rogers?

A. No, I do not.

Q. Do you know what happened to it?

A. Yes, I do.

Q. Will you state what happened to it?

A. Well, Mr. Lindberg took it from my husband's room the day following his death.

Q. From the hotel room, the Page Hotel at Willcox? A. Yes. [98]

Q. Was that with your knowledge or consent?

A. No, it was not. It was against my instructions.

(Testimony of Lois Rogers.)

Q. Did you subsequently ask for the return of that policy? A. I did.

Q. What did he say?

A. He said that he would not give it to me.

Q. Now, you have been advised, have you, that the sole cause of your husband's death was this accident? A. Yes.

Q. Where and when was your husband buried?

A. He was buried here in Phoenix, February 1st, 1940.

Q. Now, subsequent to his burial, did you make demand on the company for the necessary blanks to prove the death of your husband?

A. Yes, I did.

Q. To whom did you make the demand?

A. To Mr. Lindberg

Q. Yes, and what did he say?

A. He said that I could not have the forms to fill out because I could not—they would not pay on the policy anyway.

Q. He didn't give you the forms? A. No.

Q. And he said they were not responsible on the policy? A. Yes. [99]

Q. Is that the reason why you have not made formal proof of your husband's death?

A. That is right.

Q. Now, since that time have you asked them to pay this policy, at that time or since your husband's death? A. Yes, I asked twice.

Q. That is since your husband's death?

(Testimony of Lois Rogers.)

A. Since his death.

Q. And before you brought this suit?

A. Yes.

Mr. Dougherty: That is all. You may take the witness.

Mr. Ross: We have no questions.

The Court: That is all.

Mr. Dougherty: Now, I want to reserve the right to recall this witness after I progress further with the case.

The Court: All right.

(The witness was excused.)

Mr. Dougherty: Mr. Caskey. I would like to announce that we are calling Mr. Caskey as Cashier of the defendant company. At this time I would like to ask counsel if they would introduce the policy that the suit is involved on.

(Thereupon the document was produced by Mr. Ross.)

Mr. Dougherty: May we have this marked for identification? Wait a minute, there are three parts to it, are there not?

Mr. Ross: Yes. [100]

Mr. Dougherty: In the application. You may mark it.

(Thereupon the document was marked Plaintiff's Exhibit 3 for identification.)

D. F. CASKEY

was called as a witness for cross-examination by the plaintiff, and having been heretofore duly sworn, testified as follows:

Cross-Examination

Mr. Dougherty:

Q. I hand you Plaintiff's Exhibit 3 for identification, Mr. Caskey, and ask you to examine it—will you please state your name for the record, Mr. Caskey? A. D. F. Caskey.

Q. Have you examined the instrument?

A. Yes, sir.

Q. Your name, I was a little premature in offering it. Your name is Mr. Caskey. A. Yes.

Q. What are your initials? A. D. F.

Q. Where are you employed, Mr. Caskey?

A. You mean now?

Q. Yes?

A. In the New York Life, Title and Trust Building.

Q. What is your position? [101]

A. Cashier.

Q. And were you the Cashier of the company on December 29th? A. Yes, sir.

Q. On December 29th, 1939? A. Yes, sir.

Q. And as such, did you have charge of the policies of the life insurance company, the defendant in this case?

A. Well, yes, I suppose what you mean, did I have charge of sending the policies out?

(Testimony of D. F. Caskey.)

Q. Yes? A. I did.

Q. And you have examined this policy?

A. Today?

Q. Yes? A. Yes, sir.

Q. And this is the policy issued on the life of Zeno A. Rogers? A. Yes, sir.

Q. And did you mail this policy to Mr. Zeno A. Rogers?

A. Well, it was mailed under my supervision.

Q. It was mailed either by you or by somebody who was working under your supervision?

A. Yes, sir.

Q. Regular mail through the United States Post Office? A. Yes. [102]

Q. Postage prepaid and addressed to him where? A. Well, as I recall, Willcox.

Q. And is this policy in the same form and condition it was in when you mailed it?

A. As far as I know. I would not think there would be any change in it. It appears all to be there.

Q. This dark sheet here is a photostatic copy of the application?

A. Yes, sir; that is photostated at New York.

Q. And was a part of the policy? A. Yes.

Q. When did you next see the policy, after you mailed it to him?

A. Well, I think—well, it was after his death. I would not know the exact time about that.

(Testimony of D. F. Caskey.)

Q. And you saw it back in the New York—the office of the New York Life, is that right?

A. Yes, I recall I did.

Mr. Dougherty: That is all, Mr. Caskey.

Mr. Ross: I have no questions.

(Thereupon the witness was excused.)

Mr. Dougherty: Call Mr. Lindberg for cross-examination. I don't know whether it is necessary to state that we call this witness for cross-examination, but he is Manager for the opposite—for the defendant. We call him as such. [103]

ARTHUR F. LINDBERG

was called as a witness by the plaintiff for cross-examination, and being first duly sworn, testified as follows:

Cross-Examination

Mr. Dougherty:

Q. Will you please state your name and residence, Mr. Lindberg?

A. Arthur F. Lindberg, Phoenix, Arizona.

Q. How long have you lived here?

A. Since October 14th, 1938.

Q. And are you employed here? A. I am.

Q. By whom?

(Testimony of Arthur F. Lindberg.)

A. By the New York Life Insurance Company.

Q. How long have you been so employed?

A. Here in Phoenix?

Q. Yes? A. Since October 14th, 1938.

Q. And in what capacity?

A. From October 14th, 1938, until January 1st, 1939, my title was that of agency organizer, and on January 1st, 1939, I was appointed agency director for the company in Arizona.

Q. And where is the company's office?

A. Local office? [104]

Q. Yes?

A. At 420 Title and Trust Building.

Q. Is that the agency office for the entire State of Arizona? A. That is correct.

Q. And you are the chief executive officer for the company in the State of Arizona?

A. That is correct.

Q. And as such you employ and discharge salesmen?

A. No. The company employs the salesmen. My—I make my recommendations to the company as to the employment of the salesmen, but the final approval and the contract with the salesman comes direct from the company based on my recommendation, if they concur in my recommendation.

Q. You have power of attorney on file out at the Corporation Commission, under which you are authorized to hire and discharge agents, have you not? A. I have authority to recommend to the

(Testimony of Arthur F. Lindberg.)

company as to the hiring and discharging of agents, but the final action is by the company.

Q. Of whom does your office force consist?

A. You mean our cashier's department?

Q. Well, how is your office organized? Who do you have in there?

A. Well, we have a cashier's department which consists of a cashier, who is Mr. Caskey, and under his supervision [105] he has twelve, I believe now thirteen clerks and stenographers.

Q. Any other department?

A. Not in our local office. The agents whom we appoint out in the field are under my supervision. They operate independently, under an independent contract from the home office.

Q. Well, they operate out of your office?

A. Yes.

Q. Your business operations extend over the entire State of Arizona?

A. That is correct.

Q. And you have a large number of agents?

A. Approximately forty throughout the State of Arizona.

Q. Each one selling life insurance?

A. Yes.

Q. In his lifetime, were you acquainted with Zeno A. Rogers?

A. I was.

Q. And I believe he was employed as an agent by your company?

A. He had filed an application to be employed as an agent and he had signed the necessary con-

(Testimony of Arthur F. Lindberg.)

tract papers and they, in turn, had been forwarded to our home office for their final approval.

Q. Well, he had been employed as an agent, had he? [106]

A. Yes, at my recommendation.

Q. Well, it wouldn't make any difference? I wasn't asking that. I move that it be stricken. You had employed Zeno A. Rogers as agent, had you not?

A. I had authorized him to write and solicit applications for life insurance until such time as his contract was approved by the company.

Q. Is there any particular reason for you avoiding a direct statement that you employed him?

A. Well, I do not employ salesmen. The company——

Q. You are the man he talked to and sought employment? A. Yes.

Q. You are the man that put him to work?

A. I authorized him to solicit and write applications for life insurance, but I have no authority to approve any contract.

Mr. Dougherty: I move that be stricken from the records, not responsive to the question.

The Court: It may stand. That is the way he explained it in the beginning.

Mr. Dougherty: Now, when did he start to work?

The Witness: He arrived in Willcox, as I recall, either the latter part of October or the first part of November.

(Testimony of Arthur F. Lindberg.)

Q. Did he continue to work up to the time of his death? A. That is correct. [107]

Q. Now, about December 7th, Mr. Rogers applied for a policy in your insurance company?

A. I believe that is the correct date.

Q. And that application was sent forward to your New York office, was it?

A. That is correct.

Q. And was there approved? A. Yes.

Q. And returned to your local office?

A. Yes.

Q. And I show you Plaintiff's Exhibit 3 for identification and ask you if that is the policy applied for by Mr. Rogers and approved by your company, mailed to Mr. Rogers by Mr. Caskey?

A. Yes, this is the policy. It was mailed under Mr. Caskey's supervision.

Q. That is properly executed by your company?

A. Yes.

Mr. Dougherty: We offer this policy in evidence.

Mr. Ross: There is no objection.

(Thereupon the document was received as Plaintiff's Exhibit 3 in evidence.)

(Testimony of Arthur F. Lindberg.)

PLAINTIFF'S EXHIBIT No. 3

New York Life Insurance Company

A Mutual Company Founded in 1845

Agrees to Pay

to Lois W., Wife of the Insured, or in Event of Her Prior Death, to Gale A. and Russel L. Rogers, Sons of the Insured, Share and Share Alike, or to the Survivor, Beneficiary (with right on the part of the insured to change the beneficiary in the manner provided herein), Two Thousand Dollars (the face of this policy) upon receipt of due proof, on forms prescribed by the Company, of the death of Zeno A. Rogers, the Insured, or Four Thousand (double the face of this policy) Dollars if such death resulted, before the anniversary of this Policy on which the Insured's age at nearest birthday is 65, from accidental means as defined in and subject to the provisions set forth under "Double Indemnity."

And upon receipt of due proof that the Insured is totally and presumably permanently disabled before the anniversary of this Policy on which the Insured's age at nearest birthday is 60, the Company agrees to waive payment of premiums, as provided under "Waiver of Premiums in event of Total and Permanent Disability."

This contract is made in consideration of the application therefor and of the payment in advance of the sum of \$40.50, the receipt of which is hereby

(Testimony of Arthur F. Lindberg.)

acknowledged, constituting the first premium and maintaining this Policy for the period terminating on the Nineteenth day of June Nineteen Hundred and Forty, and of a like sum on said date and every Six calendar months thereafter during the lifetime of the Insured.

The premium paying period may be shortened by application of dividend additions and dividend deposits as provided herein. [40]

(The above premium includes \$1.54 for the Double Indemnity Benefit and \$2.16 for the Disability Benefit.)

This Policy shall take effect as of the Nineteenth day of December, Nineteen Hundred and Thirty-Nine, which day is the anniversary of this Policy.

The Benefits and Provisions printed or written by the Company on the following pages are a part of this contract as fully as if they were recited at length over the signatures hereto affixed.

In Witness Whereof the New York Life Insurance Company has caused this contract to be signed this Nineteenth day of December, Nineteen Hundred and Thirty-Nine.

ALFRED L. AIKEN

President

FREDERICK M. JOHNSON

Secretary

D. D. LURIE

Registrar

(Testimony of Arthur F. Lindberg.)

939-50

O. L.

D.-D. I.

Age 42

Examined EE

BP

Ordinary Life. Insurance Payable at Death.

Premiums Payable during Lifetime unless Dividends Applied to Shorten Premium Paying Period. Waiver of Premium Disability Benefit. Double Indemnity Benefit. Annual Participation in Surplus.

The Contract: This Policy and the application therefor, copy of which is attached hereto, constitute the entire contract. All statements made by the Insured shall, in the absence of fraud, be deemed representations and not warranties, and no statement shall avoid this Policy or be used in defense to a claim under it, unless it is contained in the written application and a copy of the application is indorsed upon or attached to this Policy when issued. No agent is authorized to make or modify [41] this contract, or to extend the time for the payment of premium, or to waive any lapse or forfeiture or any of the Company's rights or requirements. All benefits under this policy are payable at the Home Office of the Company in the City and State of New York, and the surrender of this Policy will be required in any settlement thereof. [42]

(Testimony of Arthur F. Lindberg.)

INDORSEMENTS
PERMANENT AVIATION CLAUSE

Anything in this Policy to the contrary notwithstanding, the death of the Insured as a result directly or indirectly from operating or riding in any kind of aircraft, whether as a passenger or otherwise, other than as a fare-paying passenger in a licensed passenger aircraft provided by an incorporated passenger carrier and operated by a licensed pilot on a regular passenger route between definitely established airports, is a risk not assumed under this Policy, but upon receipt of due proof of the death of the Insured, as a result directly or indirectly from operating or riding in any kind of aircraft, whether as a passenger or otherwise (other than as a fare-paying passenger as defined above) the Company will pay to the beneficiary in lieu of the amounts provided in this Policy, the reserve on the face amount of this Policy at the date of death, and the reserve on any outstanding dividend additions, and any outstanding dividends, including dividend deposits, less any indebtedness to the Company against this Policy.

NEW YORK LIFE INSURANCE CO.
By FREDERICK M. JOHNSON

Secretary

New York, Dec. 19th, 1939
996-32(A)

(Testimony of Arthur F. Lindberg.)

In accordance with the provisions of the Insurance Law of Arizona, settlement under this policy, if it becomes a claim by the death of the Insured, shall be made upon receipt of due proof of death and of the interest of the claimant, and not later than two months after the receipt of such proofs.

NEW YORK LIFE INSURANCE CO.

By FREDERICK M. JOHNSON E
Secretary

New York, Dec. 19th, 1939

(897-21) [43]

New York Life Insurance Company,
51 Madison Avenue,
New York, N. Y.

Gentlemen:

It is understood and agreed that Policy No. 17 507 735 is written with the following endorsement:

PERMANENT AVIATION CLAUSE

Anything in this Policy to the contrary notwithstanding, the death of the Insured as a result directly or indirectly from operating or riding in any kind of aircraft, whether as a passenger or otherwise, other than as a fare-paying passenger in a licensed passenger aircraft provided by an incorporated passenger carrier and operated by a licensed pilot on a regular passenger route between

(Testimony of Arthur F. Lindberg.)

definitely established airports, is a risk not assumed under this Policy, but upon receipt of due proof of the death of the Insured, as a result directly or indirectly from operating or riding in any kind of aircraft, whether as a passenger or otherwise (other than as a fare-paying passenger as defined above) the Company will pay to the beneficiary in lieu of the amounts provided in this policy, the reserve on the face amount of this Policy at the date of death, and the reserve on any outstanding dividend additions, and any outstanding dividends, including dividend deposits, less any indebtedness to the Company against this Policy.

ZENO A. ROGERS

Applicant

Dated Dec. 19th 1939

Witness

Forwarded to the Comptroller's Department
from Arizona Branch Office. [44]

STATEMENT OF PROFIT AND LOSS FOR YEAR 1935

	Total All Divisions	Oakland-Hayward Division
Operating Expenses (Brought Forward).....	\$214,247.69	\$110,117.38
Administration Expenses		
Gen'l. Off. Sals. & Exp.....	\$ 11,028.34	\$ 5,668.26
Gen'l. Off. Clerks—Sals. & Exp.....	6,573.34	3,378.51
Stationery, Prtg. & Supplies.....	2,009.72	1,032.94
Misc. Gen'l. Office Exp.....	249.11	128.04
Telegraph & Telephone.....	1,289.01	662.51
General Legal Expense.....	4,395.88	2,259.36
Misc. Expense.....	349.37	179.57
Total Administrative Exp.....	\$ 25,894.77	\$ 13,309.19
Total Operating Expense.....	\$240,142.46	\$123,426.57
Operating Taxes, Rents & Depreciation		
Operating Taxes		
Gasoline Taxes.....	\$ 13,000.43	\$ 6,681.86
Public Utility Taxes.....	19,457.70	10,000.72
Federal Cap. Stock Taxes.....	112.00	57.56
Federal Excise Taxes.....	6,142.02	3,156.83
Total Operating Taxes.....	\$ 38,712.15	\$ 19,896.97
Operating Rents		
Shop Rents.....	\$ 2,700.00	\$ 1,387.73
Terminals & Stations Rents.....	316.00	162.41
Office Rent.....	810.00	416.32
Joint Facilities Rents.....	4,200.00	2,158.68
Total Operating Rents.....	\$ 8,026.00	\$ 4,126.14
Depreciation & Retirements		
Depreciation of Busses.....	\$ 30,963.18	\$ 15,914.21
Depreciation Other Prop'ty.....	4,931.37	2,534.59
Total Depr. & Retirements.....	\$ 35,894.55	\$ 18,448.80
Total Oper. Taxes, Rents & Depr.....	82,632.70	42,470.91
Total Oper. Costs.....	\$322,775.16	\$165,897.48
Net Operating Loss.....	\$ 28,960.61*	\$ 57,346.76*
Other Income		
Non-Oper. Prop'ty. Rentals.....	\$ 918.00	
Miscellaneous Income.....	284.84	
Profit or Loss from Disposal of Depr. P'ty.....	894.99*	
Total Other Income.....	307.85	
Net Income.....	\$ 28,652.76*	
Other Deductions		
Interest Paid.....	\$ 1,595.15	
Misc. Inc. Chgs.....	142.18	
Non-Oper. Prop'ty. Exp. & Taxes.....	530.35	
Total Other Deductions.....	2,267.68	
Net Profit.....	\$ 30,920.44*	\$ 57,346.76*
Adjustments		
Add: Self Insurance Charges.....	\$ 8,679.66	\$ 4,461.35
Capitalization of 1935 Hayward Development Costs.....	\$ 52,885.41	52,885.41
Adjusted Net Profit.....	\$ 30,644.63	—0—

[104]

Page 3

5. a. The following is all the insurance now in force on my life: Western States \$5000.00.

State name of Company and Amount. (If none, say none)

b. The insurance for which I am now applying is not intended to take the place of insurance carried with this or any other Company. If it is, give particulars:—No.

6. Of the insurance on my life the amount which includes benefits in event of total disability is \$5000.00.

7. No Company has declined to issue insurance on my life or issued or offered to issue insurance on my life differing from the insurance applied for, except as follows: (If none, say none) None.

8. I have participated as a passenger or otherwise in aviation or aeronautics.

9. Additions or amendments (For Home Office use only).

It is mutually agreed as follows: 1. That the insurance hereby applied for shall not go into force unless and until the policy is delivered to and received by the applicant and the first premium thereon paid in full during his lifetime, and then only if the applicant has not consulted or been treated by any physician or practitioner since his medical examination, and thereupon the policy shall be deemed to have taken effect as of the date specified under 3 above; provided, however, that if the applicant, at the time of making this application, pays the soliciting agent in cash the full

amount of the first premium for the insurance hereby applied for, and so declares in this application and receives from the soliciting agent a receipt therefor on the form attached as a coupon to this application and corresponding in date and number therewith, and if the Company, after medical examination and investigation, shall be satisfied that the applicant was, at the time of making this application, insurable and entitled under the Company's rules and standards to the insurance, on the plan and for the amount hereby applied for, at the Company's published premium rate corresponding to the applicant's age, then said insurance shall take effect and be in force under and subject to the provisions of the policy applied for from and after the time this application is made, whether the policy be delivered to and received by the applicant or not. 2. That the soliciting agent is not authorized to collect any premium for the insurance hereby applied for except the first premium thereon, which in no event shall exceed one annual premium for such insurance, together with the premium for preliminary term insurance, if any, and that a receipt on the form attached as a coupon to this application and corresponding in date and number therewith is the only receipt the soliciting agent is authorized to give for any payment made hereunder before the delivery of the policy. 3. That only the President, a Vice-President, a Secretary or the Treasurer of the Company can make, modify or

discharge contracts, or waive any of the Company's rights or requirements; that notice to or knowledge of the soliciting agent or the Medical Examiner is not notice to or knowledge of the Company, and that neither of them is authorized to accept risks or to pass upon insurability. 4. That by receiving and accepting said policy, any additions or amendments hereto which the Company may make and refer to under 9 above entitled "Additions or Amendments" are hereby ratified.

Dated at Willcox, Ariz. this 7 day of Dec. 1939.

[Signature of the person applying for insurance]

ZENO ADDISON ROGERS

Witnessed by Z. A. Rogers Soliciting Agent.

Other Soliciting Agents.....

[Names and Residences of three intimate friends]

FRANK SELLARDS

Phoenix, Ariz.

FRANK LAMONT

Tempe, Ariz.

STANLEY CLEM

Phoenix, Ariz.

[Reverse not filled in] [45]

17-507-735

NEW YORK LIFE INSURANCE COMPANY

This blank is to be filled out by all Applicants where the question of possible Aeronautical activities arises in connection with his or her Application.

	Flights	Hours Flown
1.a. How many flights have you made?	a. About 500	a. 1200
b. How many flights within last two years?	b. " 10	b. 30
c. How many flights within last year?	c. 5	c. 5
d. How many flights within last six months?	d. 2	d. 1
e. When, approximately was, the last ascension?	e. One month ago	
f. Were they taken as fare-paying passenger, non-fare-paying passenger, mechanic, observer or pilot? (Specify)	f. Pilot	
g. Were they made in planes flying regularly between established airports over a scheduled air transport route? (If not, give full details.)	g. Army in 1917 & 18	
h. What was the purpose of flights—business, business experimental, pleasure or student under instruction?	h. Student & Instruction	
i. What was the character of Aircraft used—Commercial, Employer-owned, Government-owned, Self-owned, other plane? (Specify)	i. Gov. owned	
2.a. Do you now hold a pilot's license? If so, what kind?	a. Transport	
b. Have you ever held a pilot's license? If so, when and what kind?	b. See ans. to a	

e. What is the total number of solo hours you have flown to date?

c. About 1250

d. What is the approximate number of hours flown as pilot in preceding twelve months?

d. (Please enumerate)

Kind of flying	Hours flown
1. Scheduled
2. Non-scheduled crossecountry	600
3. Non-scheduled short hops	200
4. Student instruc- tion (Instructor only)	400
5. Test or experi- mental	30
Total number	1230

[46]

e. Have you ever engaged in, or do you contemplate engaging in, glider, dirigible, or balloon flying, test or stunt flying, student instruction? when, and give full details?

e. No

f. Have you ever experienced any aviation accidents? If so, when and give full details?

f. No

3.a. Have you had any training in operating aircraft? If so, when and for what purpose—commercial or private pleasure?

a. Yes—U. S. Aviation Corps 1917-1918

b. Do you contemplate any training in operating aircraft? When and for what purpose?

b. No

c. Do you own any aircraft? What type?

c. No

d. Do you contemplate ownership of aircraft? What type?

d. No

- 4.a. Are you now or have you ever been a member of the Federal or State Air Reserve Force, or of an Aeronautical Club? a. Yes. I have discontinued all flying
- b. If a member do you fly regularly or only during certain periods of the year? (Give details) b.
- c. Do you intend continuing your connection as above? (Give details) c. No
- d. Are you now or have you ever been employed by or connected with a business manufacturing, selling or operating aircraft? If so, state when and in what capacity. d. No
- e. Does the business with which you are connected maintain any aircraft for use of its officers or employees? e. No
-
5. To what extent do you contemplate making use of any aircraft and in what capacity? In case of an accident I *wave* all insurance.
-

I hereby agree that the foregoing answers are full, complete and true and together with the questions shall form a part of an application for insurance made by me to the New York Life Insurance Company on Dec. 7-1939. and I hereby renew and confirm my agreement therein.

Dated at Willcox, this 11 day of Dec. 1939.

[Applicant] Z. A. ROGERS [47]

[Witness] ARTHUR F. LINDBERG

[Endorsed]. Pltf's Exhibit No. 3 Lois Rogers vs. N.Y. Life Ins. Co. Case No. Civ-146 Phx Marked for identification Apr 22 1941 admitted and filed Apr 22, 1941 Edward W. Scruggs, Clerk, United States District Court for the District of Arizona by Wm. H. Loveless, Chief Deputy Clerk. [48]

Mr. Dougherty: Mr. Lindberg, after Mr.— will you please strike that out. Mr. Rogers was killed as a result of an accident near Fort Huachuca, was he? A. Yes. [108]

Q. About the 27th, was it?

A. The accident occurred on the 26th. His death, I understand, occurred on the 28th.

Q. Now, after his death and funeral, Mrs. Rogers asked for blanks for the proof of death, did she not? A. She didn't ask me.

Q. Well, did you tell her that the company was not responsible on this policy?

A. Our first conversation about the policy, as I recall, was over the telephone the day of Mr. Rogers death.

Q. Well, I am not interested in that. Did she, after this funeral, after the death, ask you for those forms, to make proof of death?

A. She did not ask me for the forms.

Q. On or about that time, that is, after the funeral, did you have a conversation, any conversation with Mrs. Rogers concerning that policy?

A. Along in the first part of March, Mrs. Rogers came into the office one day and said, "Mr. Lindberg, where is that policy? I am going to bat on it", and I said, "Mrs. Rogers, I am just as sorry as anybody could be that this policy was not in effect, but the truth is that the premiums are not paid and, therefore, I am afraid you would be just wasting your time going to bat on it". At that time she did not ask for claims or any other papers. That seemed to satisfy her. [109]

Q. Satisfy her that you weren't going to pay, is that right? A. She made no further request.

Q. In other words, you told her you were not going to make any payment?

A. I didn't make any such statement. I said the policy was not in effect, I thought she would be wasting her time trying to collect from it.

Q. What do you think she understood from that? A. I don't know.

Q. She probably got the impression, did she not, Mr. Lindberg, that you were not going to pay it unless she sued?

A. That is possible. I don't know. She didn't tell me what impression she got.

Mr. Dougherty: That is all.

Mr. Ross: No questions.

(Thereupon the witness was excused.)

Mr. Dougherty: Now, the policy, your Honor, is lengthy. Whether to read it all to the jury or not—

The Court: No, I don't know. That has never been done that I have ever heard.

Mr. Dougherty: I don't want to overlook that part of it and am wondering about passing it to the jury. It may take some time.

The Court: Oh, they don't want to read it.

Mr. Dougherty: May I state that this is the policy [110] issued by the New York Life Insurance Company on the life of Zeno A. Rogers for \$2,000.00 and providing for double indemnity in the case of death by accident. Attached to this policy is an original application under which the policy was issued, and among the parts of the application for the policy, Mr. Rogers expressly waived any claims from accidents on account of flying, the language being: "I hereby discontinue all flying." ("I have discontinued all flying.") That is one part. "I hereby discontinue all flying". ("I have discontinued all flying.") In case of accidental death—no. "In case of an accident from aircraft, I waive all insurance", and that is dated on the 11th day of December, 1939. Now, if there is any other part of this policy that the jury might be interested in and which we might properly permit them to see, I will be glad to conform to their compliance. This policy is dated December 19th, 1939, and among other things contains this provision: "This contract is made in consideration of the application therefor and of the payment in

advance of the sum of \$40.50, the receipt of which is hereby acknowledged, constituting the first premium and maintaining this policy for the period terminating on the 19th day of June, 1940, and of a like sum on said date and every six calendar months thereafter during the lifetime of the insured”.

Now, your Honor, for the time being, we rest.

The Court: Very well. [111]

Mr. Ross: You say the plaintiff rests?

Mr. Dougherty: Yes.

DEFENDANT'S CASE

Mr. Ross: Call Mr. Caskey, please.

Mr. Dougherty: If your Honor please, before—I don't know, we are going to object to the introduction of any evidence on one feature of the answer here, and I am not entirely satisfied with the objection he had made in the absence or presence of the jury.

The Court: You will have to wait until the question is asked first.

Mr. Dougherty: No, it won't have to do with the question. It has to do with the matter of the pleadings.

The Court: Well, what about the pleadings?

Mr. Dougherty: Well, we do not think that the pleadings entitles the defendant to the introduction of any evidence on one feature of their answer.

The Court: Maybe they are not going to offer anything on that feature. I say, we had better wait.

Mr. Dougherty: I want to reserve the record at that time.

The Court: Well, you can object when he asks the question. We are going to try this case in as orderly a manner as possible. Go ahead. [112]

D. F. CASKEY

was called as a witness on behalf of the defendant, and having been heretofore duly sworn testified as follows:

Direct Examination

Mr. Ross:

Q. Your name is Mr. Caskey? A. Yes.

Q. Will you explain a little more in detail, Mr. Caskey, just what the nature of your duties are as Cashier for the New York Life Insurance Company?

A. Well, supervisory, just supervision of office details and the machinery of the office, and so forth; usual office duties, taking care of applications when they go in and policies when they come out; collection of premiums and accounts. The usual accounting that goes to make up a life insurance office.

Q. Do you have anything to do in the way of selling policies, dealing with the public?

A. Well, I deal with the public but I don't sell policies.

Q. Now, in what respects do you deal with the public?

(Testimony of D. F. Caskey.)

A. Well, any service that the policy-holder may want, want to discuss any of the angles on his insurance with me.

Q. Now, as Cashier of the Arizona branch office, are the books of the company kept under your supervision? [113] A. Yes.

Mr. Ross: Mark this.

(Thereupon the document was marked Defendant's Exhibit A for identification.)

Mr. Ross: Mark this.

(Thereupon the document was marked Defendant's Exhibit B for identification.)

Mr. Ross: Mr. Caskey, I hand you Defendant's Exhibit A for identification and ask you if this is a part of the bookkeeping system of the New York Life Insurance Company?

The Witness: Yes.

Q. Now, will you explain where these two sheets of paper come from, what the purpose of them is?

A. Well, this is what we call an application policy register. In other words, when an application, or you apply for insurance and the application comes into the office, why, a record is made in here under the agent's account and it gives the name of the applicant and gives the amount of insurance and the plan and details of the insurance he is applying for, and gives the date the application went to the home office for the issuance of the policy. Then, when the policy comes back the details

(Testimony of D. F. Caskey.)

of the issuance of the policy is put in here, the policy number, the date of it and the premium and the amount of money that was paid, if any was paid, and the date it was sent out to the agent, and then after that is done, when the premium is paid, it is [114] posted in here and that is the function of this register. It gives a complete picture of the application for a policy and the settlement, if any, or if it is never accepted, and the date the policy was sent back to New York to cancel.

Q. Now, do these sheets of paper contain all the records of the nature to which you have testified relating to the policies of insurance which Rogers secured as an agent of the company?

A. Yes, it carries everyone of them up to—— well, I know it is the last one because it is incomplete. It ends on the day of his death. Here, the last policy is February 6th, and the first one is about November 24th. Yes. That takes care of everyone of them.

Q. And are the entries in those sheets made under your supervision? A. Yes.

Q. In the New York Life office? A. Yes.

Q. Are they made in the regular course of the company's business?

A. Yes, from the regular routine.

Q. I will hand you Defendant's Exhibit B for identification and ask you if that is also a part of the records of the New York Life Insurance Company?

(Testimony of D. F. Caskey.)

A. Yes. A part of the bookkeeping of the office.

Q. Will you explain what the purpose of those sheets is? [115]

A. Well, this is what we call a ledger account. In other words, it shows all the credits that an agent may have due him from the company, or after the credits are made, it would show the withdrawal of any money he made from the company. In other words, it is just what it—just what you call it, a ledger of debits and credits due the agent from the company.

Q. Would it contain entries of all the premium payments which were sent in by that particular agent?

A. No, this would not show the premium payments (indicating document). This (indicating another document) would show premium payments.

Q. You are referring to—

A. I am showing the register—the register shows the premium payments. If he had no money coming on the premium payments that are made, it would not show on this at all. This only shows the commissions due him and the commissions that he withdrew.

Q. Exhibit B shows merely the commissions that he drew?

A. That is right, just like a bank account. This would show premium payments. This (indicating another document) would show his commissions. Call it a commission ledger, if you want.

(Testimony of D. F. Caskey.)

Mr. Ross: Your Honor, we offer these in evidence, Defendant's Exhibits A and B for identification.

Mr. Dougherty: May we have a little while to look at [116] them? They are lengthy sheets.

(Thereupon counsel for the plaintiff peruse documents.)

Mr. Dougherty: This, your Honor, is a lengthy sheet and it concerns a great many entries concerning other persons than Zeno A. Rogers, and I can't determine just the purpose of your offering it.

Mr. Ross: It is to show the state of the account in the company of Zeno A. Rogers, and to prove that no commissions were earned by Mr. Rogers and that no premiums were paid on the policy in question.

Mr. Dougherty: The exhibit offer is so extensive we cannot see it, but we object to it as being irrelevant, incompetent and immaterial.

The Court: They may be received.

(Thereupon the documents were received as Defendant's Exhibits A and B in evidence.)

Mr. Ross: Mr. Caskey, I show you Plaintiff's Exhibit No. 3 in evidence, which is a policy of life insurance issued on the life of Zeno A. Rogers by the New York Life Insurance Company. I will ask you if the photostat attached to the policy is a true copy of an application made by Mr. Rogers for the life insurance policy with the defendant company?

(Testimony of D. F. Caskey.)

The Witness: Yes, according to our records it is.

Q. Now, referring to Plaintiff's Exhibit 1 in evidence, would you state when such an application was made? [117]

A. When he signed the application?

Q. Yes?

A. It is dated December 7th, 1939. He was examined on December 7th.

Q. Now, is there a record of that application coming through——

A. Yes.

Q. (Continuing) ——the Arizona office?

A. Yes. Here is an entry here, "two-thousand, ordinary life." It went to New York on December 13th and this policy was issued——

Q. Will you state when this policy was issued?

A. December 19th, in New York.

Q. And referring again to Defendant's Exhibit A, would you state when the policy was received by the Arizona office?

A. Well, I can't tell so much by this, you see, because we don't put the receipt date in here. It is of no consequence. You can tell from any correspondence that may have come with the policy. This policy was—it would be received in Arizona about the 23d of December, somewhere around there.

Q. Now, was the policy which was issued the same as the policy which was applied for?

Mr. Dougherty: We object to that as calling for a conclusion of the witness. The policy speaks

(Testimony of D. F. Caskey.)

for itself. The application and the policy are altogether and whether [118] they are the same or not calls for——

The Court: Well, he may answer.

The Witness: No, it was not.

Mr. Ross: Wherein was the policy changed or modified?

A. Well, it has an aviation rider in it.

Q. And this rider attached to the policy, is it the original or a copy of the agreement pertaining to the——

A. No, this would be a copy; this is a copy.

Q. Would you explain to the jury, Mr. Caskey, how that is handled; what is done with the original?

A. Well, when an application goes to the home office, when you are applying for insurance on a certain plan, if they don't issue on that plan or modify your application or put a rider on it as in this particular case, they attach a copy of it to the policy and then the original which you accept is left unattached and it comes out with the policy and then we get the applicant, and when the policy is presented to him, well, then he has to accept the policy with the modifications. In other words, he accepts the policy with the modifications by signing the amendment or rider, whatever you want to call it, accepting it. In this particular case they modified his application by putting what they call a permanent aviation clause in there, which is a restriction on the hazard, and then if he wants that

(Testimony of D. F. Caskey.)

policy that way, he has to sign that rider, that acceptance of that modification, otherwise there would not be anything [119] for him to sign. The acceptance of the policy the way it is and the payment of the premiums is satisfactory, you know, the conclusion of the deal.

Q. What is done with the original form of the rider after the applicant has signed it?

A. It is sent to the home office and filed and a copy of it is left in the policy.

Mr. Ross: Mark this.

(The document was marked Defendant's Exhibit C for identification.)

Mr. Ross: Mr. Caskey, I hand you Defendant's Exhibit C for identification and ask you whether or not these were the instruction received by the Arizona office together with the policy when it was forwarded from the home office?

A. Well, it could be verified by the number 17,507,735. Yes, this is the letter that came from New York with it, that is right.

Q. What did you call such a——

A. You mean this (indicating exhibit)? This hasn't any particular name. It is merely a form that they attach to the policy. It has about 18 different instruction headings on there and they mark the one—if there is anything for you to do that they are instructing you to do, they will "X" it there or they will write down here. In this particular case they sent the policy out and instructed us before delivery to have the—— [120]

(Testimony of D. F. Caskey.)

Mr. Dougherty: Just a moment, now. That has not been admitted in evidence yet, Mr. Ross, and undoubtedly it speaks for itself and it should be admitted.

Mr. Ross: Is it the standard practice to have such a letter of transmittal accompany every policy?

The Witness: If there are any instructions, otherwise, if there is nothing to be done and no instructions, why—and no exceptions to the application, why, they don't put it on there, no necessity for it.

Q. This was instructions from the company on the policy in question? A. Yes.

Mr. Ross: We ask that this be admitted in evidence.

Mr. Dougherty: May I ask a question?

Q. Did you show this letter to Mr. Rogers?

The Witness: No, I never saw Mr. Rogers.

Q. So far as you know, Mr. Rogers knew nothing about this letter?

A. No, he would never see that letter.

Q. This all amounts to a communication, then, between your home office in New York and your Phoenix office here?

A. In substance, to the Phoenix office. You are talking about that letter, that long form?

Q. Talking about the import of the whole——

A. I am not talking about all of it, I am talking

(Testimony of D. F. Caskey.)

about that one letter that accompanied the policy. That is between [121] the home office and the branch office.

Q. Well, this instrument is offered as a whole now?

A. Well, I am talking about this one, this right here (indicating document). That came with the policy and is instructions from the New York office to the Phoenix office.

Q. Were all parts that are now attached here, were they all attached when you got it?

A. Got the policy?

Q. No, when you got the letter?

A. No, no. These are prepared here in Phoenix.

Q. This is all you got from New York (indicating document)?

A. That is right; that is right.

Mr. Dougherty: We object to this. In the first place, these papers, the first two papers, and I presume the last papers are papers prepared in the local office that Rogers had nothing to do with and knew nothing about, and the other one is one he speaks of as coming from New York, is one that concerns the Phoenix office and the home office only and to which Rogers' attention was never called and regarding which he knew nothing. In other words, it is a self-serving declaration, nothing more. They are trying to show that instructions that were never brought to the attention of a third party may be enforced against a third party.

(Testimony of D. F. Caskey.)

Mr. Ross: Your Honor, as to the sheets attached to [122] that, we have no need to include them in the offer and the record may so show. The purpose of the offer is to substantiate our proof that the policy was forwarded to the applicant through mistake.

Mr. Dougherty: Now we ask that that statement of counsel be stricken. That is an issue in this case regarding which we think counsel has no right to make such a statement.

The Court: All right. Don't pay any attention to what either counsel say. Are those the two letters that were received from the home office, the two documents?

The Witness: Just one, your Honor, that one you have in your right hand. That is merely a carbon copy of certain details of the application as it passed through the office on the way to New York, just for our own records, of the name and age and address and so forth.

The Court: Well, then, this may be received.

Mr. Connor: Sir?

The Court: This may be received.

(Thereupon the document was received as Defendant's Exhibit C-1 in evidence.)

(Testimony of D. F. Caskey.)

DEFENDANT'S EXHIBIT No. C-1

Division of Policy Issues

Arizona Branch Office

New York, Dec. 19, 1939

Re Policy No. 17 507 735 Rogers

Gentlemen:

We send the enclosed Policy subject to the requirements or information indicated by x mark.

1. Before delivery of Policy No. have the enclosed new application signed by applicant and duly witnessed. Vital B.O.
2. In the application for this Policy applicant stated that he was born A previous application gives date of birth as Please let us have a statement over applicant's signature which date is correct.
3. The agent in this case neglected to give the Beneficiary's Christian Name in Full as called for in the application. Before delivery of policy, please obtain same over applicant's signature and forward to Home Office for our records.
4. Before delivery of Policy obtain from our Examiner without expense to the Company, satisfactory certificate of applicant's present good health and send same to this Office. Policy must not leave your hands until Health Certificate is furnished. Vital B.O.

(Testimony of D. F. Caskey.)

5. If this Policy is not delivered within fifteen days from the date it is billed to the agent, satisfactory medical health certificate without expense to the Company will be required.

6. Before delivery of Policy, obtain and send to this Office Examiner's Certificate that Vital B.O.

7. Please have our Examiner re-examine applicant's urine and certify that it is normal and specific gravity is between 1015 and 1025. Cashier to hold Policy until such Certificate re urine is in his possession. Vital B.O.

8. Before delivery of Policy, obtain and send to this Office Examiner's Certificate that query of his Report should be answered. Vital B.O.

9. Regardless of instructions printed on this form, Cashier is to hold this Policy until
V.H.O. × released. The Home Office alone has authority to release the Inspection Report in this case.

10. Regardless of instructions printed on this form, Cashier is to hold this Policy until released by our Medical Board. The Home Office alone has the authority to Order such release.

(Testimony of D. F. Caskey.)

11. Regardless of instructions printed on this form, Cashier is to hold this Policy until released. The Home Office alone has authority to order such release.
12. Policy No. is alternative with Policy No. and only may be delivered. [50]
13. Inspection Report in this case received at Home Office, and Policy may be delivered in accordance with the Company's rules.
14. Mark Policy No. void and return it with Form 2005, and give number of Policy issued in lieu.
15. In connection with the delivery of this Policy, you will please carry out instructions contained in letter from under date of
16. Date of birth and age changed to agree with information which we have on file. If incorrect, submit documentary evidence of change.
17. In view of the medical rating requiring us to write the Policy with we do not send you the Policy requested. On written request of the agent, the Company will consider issuing such Policy on the plan with
18. Before delivery of Policy have the enclosed Self-Health Certificate signed by the appli-

(Testimony of D. F. Caskey.)

cant and duly witnessed. Vital B.O. (See footnote on Certificate.)

A. E. WIEST

Superintendent

MM

Vital B.O. Before delivery of above policy the enclosed Amend. must be signed, witnessed and returned to this office.

Vital Requirements

Vital B.O.: When requirements on this sheet are marked "Vital B.O." Cashier must hold the policy until requirement is in his hands. If, however, the Agency Director is satisfied that the agent in this case is reliable, and that it is necessary for him to have the policy in order to facilitate delivery, you may, upon Agency Director's approval, give the policy to the agent, with the instructions that under no circumstances may it be delivered to the applicant until the above requirement has been obtained and found satisfactory.

Vital H.O.: When requirements are marked "Vital H.O." the Cashier must hold the policy until notified by the Home Office that policy may be delivered to the agent.

Requirements not marked either "Vital H.O." or "Vital B.O." are known as "Simple" and are to be forwarded to Selection and Rating Dept.

When the Cashier receives a "Vital B.O." requirement he must immediately forward same to

(Testimony of D. F. Caskey.)

the Comptroller's Department except Medical Vital H.O. requirements which must be sent to the Selection and Rating Department. [51]

New York Life Insurance Company
Division of Policy Issued

A. E. WIEST, Superintendent

New York,

Instructions to the Cashier..... Branch Office
No..... Name.....

In connection with the above, please note as follows:

Vital Requirements

Vital B.O.:—When requirements on this sheet are marked "Vital B.O.," Cashier must hold the policy until requirement is in his hands. If, however, the Agency Director is satisfied that the agent in this case is reliable, and that it is necessary for him to have the policy in order to facilitate delivery, you may, upon Agency Director's approval, give the policy to the agent, with the instructions that under no circumstances may it be delivered to the applicant until the above requirement has been obtained and found satisfactory.

Vital H.O.:—When requirements are marked "Vital H.O.," the Cashier must hold the policy un-

(Testimony of D. F. Caskey.)

til notified by the Home Office that policy may be delivered to the agent.

Requirements not marked either "Vital H.O." or "Vital B.O." are known as "Simple" and are to be forwarded to Selection and Rating Dept.

When the Cashier receives a "Vital B.O." requirement he must immediately forward same to the Comptrollers' Department except Medical Vital H.O. requirements which must be sent to the Selection and Rating Department.

A. E. WIEST

Superintendent [52]

[Endorsed]: Deft's Exhibit No. C-1. Rogers vs. N. Y. Life Ins. Co. Case No. Civ-146 Phx. Marked for Identification. Admitted and filed Apr. 22, 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona. By Wm. H. Loveless, Chief Deputy Clerk. [53]

Mr. Ross: Mr. Caskey, would you explain the method of handling the policies as they come in from the New York office to the Arizona branch office and are forwarded to the agents?

The Witness: You mean all the policies that are going [123] to go out to the agents? You mean, new policies?

Mr. Ross: All new policies?

Mr. Dougherty: Well, we object to that as irrelevant, incompetent and immaterial. On what theory

(Testimony of D. F. Caskey.)

are you offering the general practice of the office?

Mr. Ross: We are showing how this policy was handled.

Mr. Dougherty: Well, this witness as he handled it or handled it under his supervision, he can testify directly about this policy.

The Court: Yes, that is probably right.

Mr. Ross: When this policy was received from the New York office, what was done with it?

The Witness: It was entered in this register, those large sheets, the details of it, the policy number and the premium and then the date it was forwarded to the agent in this particular case. The insured or applicant is also put in the register and then a record of it is made on a card, certain details of it, and then it is sent to the agent and with it is a, what you may call an invoice form giving him certain instructions on there as to what to do or what not to do, requirements and different things of that sort. That is all there is to handling policies in a branch office.

Q. And about how many policies are handled a day, as a general rule?

A. Well, you mean on an average day?

Q. On an average day? [124]

A. Oh, I'd say we would handle possibly 350 or 400 policies a month. Of course, on occasion you would have—you may have on some days a hundred policies to handle and the next day you would

(Testimony of D. F. Caskey.)

only have 20, but for a possible average, 350 to 400 a month over there.

Q. Now, is it the company's general practice in handling policies issued on the lives of agents different in any way than handling policies issued on lives of other applicants? A. Oh, yes.

Mr. Dougherty: Just a moment. You are speaking now of the practice followed in this case?

Mr. Ross: We are speaking of the practice involved pertaining to this case.

Mr. Dougherty: Unless the matter was brought to the attention of Mr. Rogers, it wouldn't have any effect in this case, would it? We object to it as incompetent, irrelevant and immaterial. If your purpose is to attempt to establish the general practice not brought to the attention of Mr. Rogers, we object to it. It is irrelevant, incompetent and immaterial.

Mr. Ross: Being brought to the attention of Mr. Rogers is not in issue here. We are showing that the policy was forwarded by mistake through——

Mr. Dougherty: We object and ask that counsel's statement be stricken. There is no such pleading before this [125] Court as would authorize the defense to offer any evidence concerning any inadvertencies or mistakes. We are prepared to meet that issue as it develops. We object to the statement on that ground. That is what I had in mind when I started with the idea of interposing a motion at that time. I think I will put it formally at this

(Testimony of D. F. Caskey.)

time. We object to the introduction of any evidence under the defendant's answer here, for the reason there is no pleading of ignorance or mistake—inadvertencies or mistakes that would justify the admission of any evidence on that issue.

The Court: Well, I know. The defendant notified Zeno A. Rogers that the policy was forwarded to him in error. What is the difference?

Mr. Connor: Your Honor please, that is a conclusion of the witness. We are prepared to show the allegation of conclusion with reference to the defendant's mistake was insufficient and not properly pleaded and that evidence is not properly admissible at such time. It is not adequate, your Honor. As I understand the rule, a mistake must be pleaded like fraud, an admission or any other essential allegations. Merely saying "I did something by mistake" does not satisfy the rules of pleading. We are to know how the mistake came about, and the Court must be in a position to justify whether that constitutes a mistake. Now, in this particular case, we will say, there was no mistake. If it was anything, it was negligence. There is no mistake here. [126] They intended to send the policy and they sent it to him, and we are——

The Court: On their pleading it says, "It shall not be delivered until the first semi-annual premium thereon in the sum of \$40.50 is paid and that the applicant signed the agreement and accepted the policy as modified".

(Testimony of D. F. Caskey.)

Mr. Connor: That was the instructions between the home office and the company.

The Court: All right. They didn't do that. They sent him the policy.

Mr. Connor: Yes, which would be merely negligence on their part. They didn't—they intended to mail him that policy and they did. There was no mistake in mailing it.

Mr. Ross: That is just what we are attempting to prove, whether there was or not.

Mr. Connor: It could not be a mistake. You intended to mail the policy and you did. Now, whether that was a mistake on Mr. Caskey's part is immaterial.

The Court: Oh, well, we can argue that later. We don't have to waste that time.

Mr. Ross: Would you read the last question, please?

(The question was read by the Reporter.)

Mr. Ross: Would you explain how the practice is different?

The Witness: Well, when an agent is handling a policy for someone else other than on his own life, we bill the [127] policy to him and he is responsible for the collection of the premium. We hold him responsible. When a policy comes out on the agent's own life, there is no one to represent him, he is representing himself, with the result that we are supposed to hold the policy and tell him that upon the payment of the premium as represented

(Testimony of D. F. Caskey.)

by the policy, we will send the policy to him; that is, the payment of the premium and his signature on any amendments to his original application.

Q. How did it happen that this policy was forwarded to Zeno A. Rogers?

A. Well, it was a routine error. Out of possibly handling, maybe, twenty-five hundred or three thousand policies a year on different lives and handling them, from in groups of 50, 75 and a hundred, I guess it would be pretty much of a routine matter on the part of the typist, and when it came through she didn't notice or recognize the name of Rogers and possibly working on anywhere from 10 to 50 at one time on her desk——

Mr. Connor: We object to that as incompetent, irrelevant and immaterial and calling for a conclusion of the witness and mere hearsay, if it is not a conclusion. We do not think that a mistake can be established in that.

The Court: Well, I say, you can argue that later. I have heard that statement from you before. You will have an opportunity to argue. Just state your objection. [128]

The Witness: Anywhere from 10 to 50 policies and shows it came over her desk and she didn't recognize the name and billed it out or, rather, mailed it to him, in other words.

Mr. Ross: When did you first discover that the policy had been sent to Rogers?

(Testimony of D. F. Caskey.)

A. Well, I don't know the date, but it possibly could be told from the date of my letter to him or the date of his report that goes out to him once a month which he returns to us telling us what he has done with all the policies we have mailed to him previously.

Q. Is it the practice of the agents of the company to submit monthly reports?

A. Yes, the 15th of every month we send them a statement of the policies that they have received prior to that time on which they have not paid the premium.

(Thereupon the document was received as Defendant's Exhibit D for identification.)

Mr. Ross: Are you familiar with the handwriting of Zeno A. Rogers?

A. Yes, I think I am.

Q. I hand you Defendant's Exhibit D for identification and ask you if this is a report of the outstanding policies submitted by Zeno A. Rogers to the Arizona office?

A. Yes, it is.

Mr. Ross: We ask that this be admitted in evidence.

Mr. Dougherty: May I ask the witness a question on [129] voir dire?

Q. Mr. Caskey, I notice the capital letter "S" in one column. What does that stand for?

The Witness: I don't know. If you will let me see it, possibly I could tell you.

(The document was handed to the witness.)

(Testimony of D. F. Caskey.)

The Witness: That means "semi-annual". The premium is payable twice a year.

Mr. Dougherty: We object to the proposed exhibit on the ground it is irrelevant, incompetent and immaterial.

Mr. Ross: We would like to call your Honor's attention to the fact that this report is on his own policy, which is on a separate page.

The Court: Well, this is Rogers' own report?

Mr. Ross: It is Rogers' own report, in his own handwriting, covering the outstanding business. We offer it both as an admission by Rogers and also for the purpose of proving the circumstances surrounding the forwarding of the policy.

Mr. Dougherty: Well, we dispute very strenuously if there is any admission against interests whatever in there, or anything inconsistent——

The Court: All right, it may be received.

(The document was received as Defendant's Exhibit D in evidence.)

Mr. Ross: Will you state what you did, Mr. Caskey, on [130] receiving this report from Mr. Rogers?

A. Why, I attempted to audit the account. That is the purpose of the report. When it comes in, I take it and audit the agent's account and see if his statements on there agree with our record. In other words, if a man says, "I paid you this premium", if he states on there and said he sent you the money, I check the record to see if he did. If he didn't,

(Testimony of D. F. Caskey.)

why, I take it up with him about the discrepancy.

Q. Did you notice that Rogers' own policy was included in the report? A. Yes.

Q. And what did you do then?

A. I wrote him a letter——

Mr. Dougherty: Just a moment. May I hear the question? May I have the question read?

(Thereupon the question was read by the Reporter.)

(Thereupon a document was marked Defendant's Exhibit E for identification.)

Mr. Ross: I hand you Defendant's Exhibit E for identification and ask you if this is a letter which you wrote to Mr. Rogers?

The Witness: Yes.

Q. And what was the purpose for writing this letter? A. Well, the purpose——

Mr. Dougherty: I object to that as irrelevant, [131] incompetent and immaterial, what the purpose is.

The Court: Yes.

Mr. Ross: I ask at this time that this Defendant's Exhibit E be admitted in evidence.

Mr. Dougherty: If the Court please, we object to it as being irrelevant, incompetent and immaterial, and for the further reason that it is purely a self-serving declaration. Now, if the intention or the purpose of offering this should be that a demand was made on Rogers for the return of the

(Testimony of D. F. Caskey.)

policy, we will stipulate that such a demand was made on him at this time, but we object to the introduction of this letter which, if consciously written to serve their purpose, could not have been written in a better way.

Mr. Ross: It was written long before any question of loss had arose. It was written long before his death, in the regular course of business.

Mr. Dougherty: It was written as advocate and not as a clerk.

The Court: Well, let me see it?

(The document was handed to the Court.)

The Court: Well, I will admit the one paragraph that I have marked here. You can read that to the jury.

Mr. Ross: You will admit the paragraph?

The Court: The other does not have anything to do with this case.

Mr. Ross: The paragraph which is being admitted in [132] evidence is this. Shall I read it to the jury?

The Court: Yes.

Mr. Ross:

“The policy issued on your life was forwarded to you in error as until settlement of the first premium has been made in cash. We are not permitted to forward a policy to an agent on his own life. Therefore, will you please see that the policy is returned to the office at

(Testimony of D. F. Caskey.)

once to be held until you can make settlement of the first premium."

DEFENDANT'S EXHIBIT E

New York Life Insurance Company

Arizona Branch Office

Suite 420 Title and Trust Building, 114 W. Adams St., Phoenix, Arizona.

Telephone: 36119, 36110.

Arthur F. Lindberg, Agency Director

David F. Caskey, Cashier

In your reply refer to file.....

Jan. 23, 1940

Mr. Z. A. Rogers

P. O. Box 126

Willcox, Arizona

Outstanding Business Report

Dear Mr. Rogers:

* * * * *

The policy issued on your life was forwarded to you in error as until settlement of the first premium has been made in cash we are not permitted to forward a policy to an agent on his own life. Therefore, will you please see that the policy is returned

(Testimony of D. F. Caskey.)

to the office at once to be held until you can make settlement of the first premium.

* * * * *

Very truly yours,

D. F. CASKEY

Cashier

(Paragraph #7 on page 1)

[Endorsed]: Defts. Exhibit No. E Rogers vs. N. Y. Life Ins. Co. Case No. Civ-146 Phx. Marked for Identification Apr. 22 1941 Admitted and filed Apr. 22 1941. Edward W. Scruggs, Clerk, United States District Court for the District of Arizona by Wm. H. Loveless, Chief Deputy Clerk. [54]

Q. Was the policy returned to the home office?
The Witness: Did I say "home office" or "branch office"?

Q. I think you said "home office"—oh, you just said "to the office"? A. To the office, yes.

Q. Was the policy returned to the office?

A. By Rogers? No.

Q. Referring to the books of the defendant company, which are defendant's—

A. Would be about the second or third page.

Q. Defendant's Exhibit A, is there any record of the premium having been paid on this policy?

Mr. Dougherty: Well, we object to that as call-

(Testimony of D. F. Caskey.)

ing for a conclusion of the witness. Of course, the record speaks for itself.

Mr. Ross: I will have him interpret the books of the [133] company.

Mr. Dougherty: You are trying to prove that record by a declaration, aren't you? The record speaks for itself.

The Court: Well, he is reading from the record. Of course, the record speaks for itself.

The Witness: No.

Mr. Ross: Is there any record shown there of any payment or payments on that form having been made on the premium on this policy?

A. No.

Q. If such a payment had been made to the New York Life Insurance Company, would it be recorded on the books of the company?

A. Would be recorded the same day.

Q. Mr. Caskey, when a person takes out a policy with the New York Life Insurance Company, does he have to pay the agent the first premium in cash?

A. No.

Mr. Dougherty: I will object to that as calling for a conclusion of the witness and it does not deal with this particular case. We are concerned here now not what was generally done, but what was done in this case.

The Court: No, you can't tell what these agents would do. This man would not know.

(Testimony of D. F. Caskey.)

Mr. Ross: The purpose of this line of questioning, your Honor—— [134]

The Court: Well, I know. How or what they are supposed to do, well, they may not do what they are supposed to do. How would it affect this case? People don't do a lot of things they are supposed to do.

Mr. Ross: I will grant you that, but I want to show Rogers' knowledge of the limits on the authority of other agents of the company.

The Court: Well, he was notified to return the policy and he didn't do it. He knew about that.

Mr. Ross: Mr. Caskey, when an agent is employed by the New York Life Insurance Company to write insurance, is he given any instructions regarding the method of soliciting insurance in the handling of the premiums?

The Witness: Yes.

Q. Are all such agents given a book of instructions relative to that? A. Yes.

Mr. Ross: Mark this.

(The document was marked Defendant's Exhibit F for identification.)

Mr. Ross: I will show you Defendant's Exhibit F for identification and ask you if this is a copy of the instructions which are given to all agents employed by the company (handing document to witness)? A. Yes.

Mr. Ross: I ask that this be admitted in evidence, but [135] the record may show that the

(Testimony of D. F. Caskey.)

markings in this booklet in red pencil were put in by counsel.

Mr. Dougherty: Which counsel?

Mr. Ross: This counsel.

Mr. Connor: That has no reference to this case?

Mr. Ross: No, no. That is not the book given out.

Mr. Connor: May we have a copy, Mr. Ross, that is not marked up by counsel?

Mr. Ross: Yes, I assume——

The Court: How much marking is on it? Perhaps they could be erased.

Mr. Ross: Two little red lines.

Mr. Dougherty: I would like to aks the witness—do you know if this booklet or one similar to it was given to Mr. Rogers?

The Witness: Yes.

Q. Who gave it to him?

A. Well, it was given to him by myself or by Mr. Lindberg. I don't know which one.

Q. Do you say you gave it to him?

A. I would not say that I, definitely that I handed it to him.

Q. You did not. You would not say that you gave it to him?

A. No, I would not say that I gave it to him.

Q. You are just guessing that one of you did?

(Testimony of D. F. Caskey.)

A. One of us would.

Mr. Dougherty: We object to it. It is incompetent, irrelevant and immaterial.

The Court: It may be received.

(The document was received as Defendant's Exhibit F in evidence.)

DEFENDANT'S EXHIBIT F.

NOTICE TO AGENTS

May 8, 1933

The following instructions to agents, supplemented by the agent's contract of employment, cover the entire scope of the agent's powers and authority, except when, in special cases, special instructions are given in writing by an officer of the Company. It is the duty of every agent thoroughly to familiarize himself with these instructions for observance of them is not merely a legal obligation, but is essential to the harmonious and successful transaction of the Company's business. In addition to this agents are reminded that, in their contracts of employment, each agent has expressly agreed with the Company to be governed strictly by the Book of Instructions to Agents issued from time to time.

This Book of "Instructions to Agents" supercedes all previous books of instructions to agents.

THOMAS A. BUCKNER

President [55]

(Testimony of D. F. Caskey.)

INSTRUCTIONS TO AGENTS

1. Authority of Agents.—Agents of the New York Life Insurance Company are authorized to solicit and receive applications for life insurance and annuities, to perform the duties specified in this Book of Instructions to Agents, and to perform such other duties in connection with said applications as the Officers of the Company may, from time to time, by special instructions, require of them.

2. Unauthorized Acts. An Agent is not authorized:

- (a) to accept risks of any kind;
- (b) to make, modify or discharge contracts;
- (c) to extend the time for paying any premium;
- (d) to bind the Company by any statement, promise or representation;
- (e) to waive forfeitures or any of the Company's rights or customary requirements;
- (f) to name any extra premium for extra risks or privileges;
- (g) to collect or receive any monies for or on behalf of, or due or to become due to, the Company except on applications obtained by or through him, and then only in exchange for the coupon receipt attached to the application corresponding in date and number with the application, and in an amount not exceeding the first premium on the insurance applied for, or except upon policies sent to him by the Com-

(Testimony of D. F. Caskey.)

pany for delivery, and then only in the amount of the first premium stated therein.

* * * * *

20. A Policy must not be Delivered.—

(a) If any change whatever has occurred in the health [56] or occupation of the applicant, or if he has consulted or been treated by a physician since the date of his medical examination. In such case the agent must at once return the policy to his Branch Office with full particulars and await further instructions. The only exception to this rule is where the full amount of the first premium has been paid in cash at the time the application was made, and the applicant has signed the declaration at the foot of the application to that effect and received the receipt provided, and the policy has been issued for the amount and on the plan applied for without advance in age or extra premium.

(b) Until the applicant signs and delivers all the papers and performs every act required of him by the Company.

(c) Until the first premium thereon is in the hands of the agent.

(d) After the expiration of one month from the date a policy is billed to the agent, (see Section 17).

* * * * *

(Testimony of D. F. Caskey.)

12. Notes. The Company will not accept a note in payment of the whole or any part of the first premium on a policy. The Company will accept cash only in payment of a first premium. If an agent takes a note, he does so at his own risk and must be personally responsible for same. Agents are instructed not to issue a coupon receipt attached to an application in exchange for a note or for anything except cash. [57]

* * * * *

[Endorsed]: Deft's Exhibit No. F Rogers vs. N. Y. Life Case No. Civ-146 Phx Marked for identification Apr 22, 1941 Admitted and filed Apr 22 1941 Edward W. Scruggs, Clerk, United States District Court for the District of Arizona by Wm. H. Loveless, Chief Deputy Clerk [58]

Mr. Ross: Mr. Caskey, as manager of the Arizona branch office, are you authorized to extend credit in payment of premiums on the policies?

Mr. Dougherty: We object to that as calling for a conclusion of the witness.

The Court: He may answer.

The Witness: You mean, extend credit on policies?

Mr. Ross: Extend credit?

A. Absolutely not.

Q. Is there any record of credit ever having been extended in this office for the payment of the premium due on this policy? A. No.

(Testimony of D. F. Caskey.)

Mr. Dougherty: We object to that as calling for a conclusion of the witness and it being entirely immaterial. He is trying to make it by including—by asking if there ever was a record of it. It has nothing to do with this case.

The Court: Well, this witness had charge of the records. He would be in a position to say whether the [137] record would disclose the extension of credit. He said no. It may stand.

Mr. Ross: What is the ruling of the Court?

The Court: The witness said “no”.

Mr. Ross: Oh, that is all.

The Court: We will take our afternoon recess at this time. Gentlemen, keep in mind the Court’s admonition.

(Thereupon a short recess was taken after which, all parties as heretofore noted by the Clerk’s record being present, the trial resumed as follows:)

D. F. CASKEY

resumed the witness stand and testified further as follows:

Cross-Examination

Mr. Dougherty:

Q. I hand you the policy in this case, Mr. Caskey, and call your attention to the application of Mr. Rogers, this part of that instrument. Will you refer to that section of the application with reference to aviation? (Handing document to witness.) Have you found it?

A. Yes, right here.

(Testimony of D. F. Caskey.)

Q. What is the number of that section?

A. You mean the number of the section on this copy?

Q. Of his application there?

A. You mean his blank, the one he completed?

[138]

Q. Yes. A. The form part of it?

Q. Yes?

A. 5,794. It is merely a company form.

Q. I understand that. Will you look again?

A. All right.

Q. You observe that in what is number 4 on the second page, there is a statement by Rogers with reference to these questions, "I have discontinued all flying"; a statement by him to that effect, is that right? A. Yes.

Q. That appears as a part of the policy?

A. Yes.

Q. Now, in the next paragraph, number 5, appears the statement, "In case of an accident I waive all insurance", an accident caused by aircraft, "I waive all insurance", is that right? A. Yes.

Q. Read this section here, will you (indicating on document)?

A. "To what extent do you contemplate making use of any aircraft, and in what capacity?"

Q. Now, will you please read the answer?

A. "In case of an accident I waive all insurance."

Q. That was said with reference to aircraft, wasn't it?

(Testimony of D. F. Caskey.)

A. Well, I don't know whether it did or not. [139]

Q. That is, it is put opposite the section that relates to it?

A. Yes, it is opposite the question. It does not answer the question, but it is opposite.

Q. Well, there was waiver of all claims on account of accident concerning aircraft, wasn't there?

A. I don't know, I can't answer that.

Q. You know the question immediately preceding it deals with aircraft? A. Yes.

Q. This question is a part of that section?

A. This question 4?

Q. Yes? Well, all this section here deals with aircraft, doesn't it? A. Yes.

Q. And he states that he has discontinued all flying. All these other answers are "No", are they not?

A. Well, the first one is not. He said he is still a member of the aeronautical club, reserve corps.

Q. That is true, he said right opposite "I have discontinued all flying"?

A. Yes, to question 4.

Q. Now, under the next question here he says, and this is a part of his application, "In case of an accident I waive all insurance"?

A. Yes. [140]

Q. That accident has reference to aircraft, hasn't it? A. That is right.

(Testimony of D. F. Caskey.)

Q. And that is the same waiver that you are speaking of as not having been signed by Rogers?

A. I can't say that.

Q. Well, it deals with the same subject, that is right?

Mr. Ross: We object to that as calling for a conclusion.

The Witness: I can't interpret the clause.

Mr. Dougherty: I will interpret it so you can. You claim that Rogers failed to sign a separate paper which is similar to the one before you and which is attached to the policy, and that paper requires a waiver, a permanent waiver of aviation insurance benefits when an accident occurs from aviation, that is right?

A. Well, I would not answer it.

Q. Well, read this over (handing document to witness)?

A. I have read it hundreds of times.

Q. What does it say?

A. I would say when he signed that he accepted the aviation clause.

Q. Yes. He had already waived any claim for compensation or, rather, insurance in the event of an accident from aviation?

A. I can't answer that.

Mr. Ross: Just a minute, please, I'd like to make an [141] objection. Your Honor please, I object to this as argumentative and calling for a con-

(Testimony of D. F. Caskey.)

clusion of the witness and the document speaks for itself.

Mr. Connor: He is merely interpreting the document.

The Court: Well, the document is in evidence. He can argue it to the jury and not to the witness.

Mr. Dougherty: May I see the other instrument aviation clause introduced by the defense? You introduced this aviation clause on a separate paper, did you not, Mr. Ross?

Mr. Ross: No, I never had the original. I don't know where it is. It is not in evidence. All the record shows, that is a copy, a true copy of the original.

Mr. Dougherty: Well, on the one attached to the policy, Mr. Rogers name is signed——

Mr. Ross: No, it is typewritten. That is the one attached to the policy there. I think the witness explained that the original was sent out to the applicant and is not attached to the policy.

Mr. Dougherty: Now, Mr. Caskey, do you say that in all cases where policies of this nature, similar policies are issued on the lives of the insured, that the premium, the first premium must be paid in advance before the policy is delivered?

The Witness: You mean on the life of an agent?

Q. No, I am speaking of—— [142]

A. No.

(Testimony of D. F. Caskey.)

Q. You do deliver policies on credit?

A. No, sir.

Q. Well, how do you get around it? You don't get cash always, do you?

A. No, the agent is responsible to us.

Q. All right. Then you deliver by credit of the agent?

A. I do not.

Q. Well, your company does?

A. No, we deliver to the agent.

Q. Yes, without the pre-payment of the premium?

A. That is right.

Q. And who do you look to for payment?

A. The agent.

Q. So that you deliver that policy then on the credit of the agent?

A. No, we deliver to the agent.

Q. And who do you look to for payment?

A. The agent.

Q. The agent?

A. Yes.

Q. Now, that is extending credit to the agent, isn't it?

A. No.

Q. No?

A. No, it is not. We hold his credits for those [143] premiums.

Q. Yes, so you look to him for payment?

A. That is right.

Q. And there was nothing about the delivery of this policy that distinguished it from the delivery of any other policy to any other agent?

(Testimony of D. F. Caskey.)

A. Well, what do you mean by that? Put it a little more clearly there.

Q. Yes. You didn't get—what you are telling this jury is, you didn't get cash before this policy was delivered? A. That is right.

Q. Now, in your ordinary practice of your business, business practice rather—

A. Yes.

Q. You do deliver policies without having received a pre-payment of the premium?

A. Well, I don't—

Q. Your company does?

A. No, the agent may.

Q. How the policy finally reaches the insured I am not concerned about, but the result of the methods you employ is, that a policy is delivered to the insured in many cases without the pre-payment in cash of the premium, isn't that true?

A. Oh, yes, the agent delivers them to the applicant without pre-payment of cash. [144]

Q. That is in accordance with your business practice? A. Yes, but he is responsible to us.

Q. Yes, so that this provision that the premium must be prepaid in cash is constantly waived by your company?

Mr. Jenckes: We object to that, your Honor please, as calling for a conclusion.

The Court: He may answer.

The Witness: In other words, you mean that the

(Testimony of D. F. Caskey.)

agents constantly deliver policies to applicants without receiving cash?

Mr. Dougherty: Well, let's leave the agent out. When you deliver a policy you use the agent to make the delivery in some cases, don't you?

A. Well, in all cases.

Q. All right. Well, in this case you didn't, did you?

A. Well, this particular case, it was on the life of the agent, but I was not the agent.

Q. Then in all cases you don't use the agent as the delivery medium?

A. Unless it is on the life of an agent. I'd qualify the agent there. I was not delivering policies. What I want to put in here is, I do not deliver policies to applicants.

Q. No?

A. And the only time that we make a direct delivery from the branch office or from me as a cashier, is when it [145] is an agent of the company.

Q. Yes?

A. Now, when you say "you", you mean me making deliveries. It can only be used when I make deliveries to the agent.

Q. I assumed you occupied an important position with the company and when I say "you", I will distinguish it. I mean your company. Your company makes delivery of policies whether through agents or by whatever means you please, they do make delivery of policies without pre-payment of

(Testimony of D. F. Caskey.)

the premiums? A. Yes, all right.

Q. And in this case you sent the policy direct to Mr. Rogers? A. That is right.

Q. And that policy was in his possession when he died, wasn't it?

A. I would not know about that. We did not have it.

Q. You did not have it?

A. In the branch office. Where it was I haven't the slightest idea.

Q. Did you subsequently learn that Mr. Lindberg took it?

A. I don't know whether Mr. Lindberg took it or not. [146] Whether the policy was sent back to the branch office or whether Mr. Lindberg brought the policy to the branch office, or whether it was sent back by the authorities down there, I don't know how it got back to the branch office. I could not answer that.

Q. You do know it was brought back to the branch office?

A. I know it was brought back to the branch office, yes.

Q. I have in my hand Defendant's Exhibit B which, according to your testimony, is the debits and credits of the premiums earned by the agent?

A. Yes.

Q. And from this record it appears that your record reaches back to December only, does it not, December 24th, 1940, you said——

(Testimony of D. F. Caskey.)

A. You said this record (indicating document) ?

Q. Yes, the last entry I see here is December 24th, 1940? A. Yes, sir; that is the last entry.

Q. And your first entry is February 24th, 1940?

A. Whatever that first entry is up there, the date.

Q. Do you have a record of the period from October 28th, when Mr. Rogers went to work for the company?

A. There was no record in that. There were no entries to make.

Q. Beg pardon?

A. There were no entries to make. [147]

Q. You mean there weren't sold any policies and there were no policies delivered?

A. We collected no premiums. He paid us no premiums.

Q. Well, just how was that handled? You received policies, did you not; he was selling policies?

A. Oh, yes, that is right.

Q. In fact, you had him classified as one of the active sellers of insurance, didn't you?

A. Well, I made no classification.

Q. No, but your record so shows?

A. That is a matter whether he was a good agent or not.

Q. Well, at any rate, this circular which has been introduced in evidence here shows him at the top of your list, does it not?

A. I don't know, I haven't seen it.

(Testimony of D. F. Caskey.)

The Court: Now, you are getting clear away from where you started.

Mr. Dougherty: I beg your pardon?

The Court: You are getting clear away.

Mr. Dougherty: Well, it is true. I have to examine the witness step by step. He was selling policies at that time, wasn't he?

The Witness: Well, you mean from the time he started?

Q. From the time of his employment and those times until after his death?

A. Well, I will tell you, the question could be [148] answered better, because I don't remember dates. We have forty men over there. That record there, the large record will tell you when he sold his first policy and exactly how many policies he got and received from the time he started to the date of the first entry, and I would say——

Q. You are familiar with the record?

A. Yes. I imagine there are several. I can look at it and tell you exactly how many. I would say several just off-hand.

Q. In other words, he had been selling considerable insurance and had sent up a number of policies?

A. Do you want to know the date of his first one here?

Q. Yes.

A. November 24th. What is that first date there, right at the top over the left-hand side, the first date, February 8th or something?

(Testimony of D. F. Caskey.)

Q. February 8th is the first entry on here?

A. All right, that is the date of his first commission. He started on November 24th. There are ten entries on the sheet, so I'd say there are ten, twenty, thirty—well, he had finished writing—at that time he had written, oh, I'd think it was, by the time the first entry appeared on there, maybe thirty-five policies.

Q. Do you know definitely how many policies he had sold? Can you ascertain from that sheet?

A. I can count them. [149]

Q. If you will, please?

A. Do you want me to count them?

Q. Yes?

A. (The witness complying) Well, I'd say 23, give or take 3 or 4 or 5, one way or the other.

Q. Beg pardon?

A. I'd say 23, give or take 4 or 5 one way or the other. That is, policies that were issued but not canceled.

Q. Now it frequently happens that policies written by the agent are canceled for one reason or another?

A. Yes.

Q. Would you please ascertain from there, if you can, the total number of policies that he sold in that interval?

A. Including the ones that were returned for cancellation?

Q. Yes?

(Testimony of D. F. Caskey.)

A. Did you say "sold" or do you mean just wrote them up?

Q. Wrote them up?

A. Well, I count 39, 39 applications that he submitted to the company. That includes declinations and all, that includes the ones we didn't take.

Q. Of this number there were about 23 or 24, you said, that were not canceled?

A. About 23 or 24 that were not canceled according to this, just counting roughly, that were delivered. [150]

Q. Now, these entries on the paper which I now have in my hand, Defendant's Exhibit B, these entries were all made after Mr. Rogers death?

A. Yes, sir.

Q. Now, these credits on the right-hand column of this Exhibit B represent the premiums that became due to him, is that right?

A. The commissions that became due to him.

Q. And over on the left-hand side is a column which indicates what?

A. Debits, the items that were charged against those commissions.

Q. And those items were for premiums?

A. Various indebtedness to the company, yes.

Q. Well, do they represent premiums or what?

A. I think mostly they would, yes. I think altogether they are premiums. At that time they could hardly be anything else.

Q. Beg pardon?

(Testimony of D. F. Caskey.)

A. At that time there could hardly be anything else. There may have been some medical fees in there later on.

Q. I assume you intend for the Court and jury that these are the correct records?

A. Oh, yes, they are made originally—made daily.

Q. Those records show a total collection of \$84.32 for February? [151]

A. What do you mean, collections by him or credits?

Q. Credits? A. Credits due him?

Q. Credits?

A. Credits due him. If that is what it totals, that is what it was.

Q. And for March, \$93.24?

A. Whatever it is.

Q. And for April, \$57.18?

A. You are getting that from the right-hand column, aren't you?

Q. Yes, I am taking the right-hand column?

A. Yes.

Q. And May, \$48.86? A. Yes.

Q. In June, \$56.32, is that right?

A. I don't know without looking at it. Whatever you read out I will stipulate is correct.

Q. July, \$32.94; August, \$29.06; September, \$2.95, so that those premiums were premiums that you collected after Mr. Rogers had died?

(Testimony of D. F. Caskey.)

A. Well, through our efforts, yes. Mr. Lindberg, I think, collected some of them. We wrote letters and collected some of them and some of them were collected by him before his death.

Q. But these premiums were collected by your company [152] on policies written by Mr. Rogers, that is right, isn't it? A. Yes.

Q. Now, do you remember between the 28th of October, which is the date, I believe, he was employed, and the 24th of February, that there were no cash premiums paid?

A. The first cash premium that we received, that the New York Life received on any business that Mr. Rogers wrote is the date that you see that first entry on that first sheet on the left-hand side. Whatever that date is, that is the date that we received the first money on any of those policies.

Q. Well, that is February 8th?

A. That is the first day that we received any money.

Q. Did you have any conversation with Mr. Rogers between the 28th day of October and the time you mailed him the policy?

A. I never saw him.

Q. You never saw him after that?

A. No, sir.

Q. Have you ever dealt with him directly before that?

A. No, I never saw him but, I think twice. One morning I talked with him a few minutes, I think,

(Testimony of D. F. Caskey.)

and another time I think I talked to him about five minutes, the only times I saw him.

Q. About when?

A. Oh, that is hard to say. I think it was shortly [153] after he came with the company.

Q. Sometime in October or November?

A. Probably. I know it was shortly after he contracted——

Q. As a matter of fact, Mr. Rogers was in the southern part of the State from the time of his employment until he came to Phoenix Christmas?

A. I think he went down there shortly thereafter. I wouldn't know exactly because I don't have anything to do with where they are placed. Mr. Lindberg will tell you exactly.

Q. Was your conversation regarding any of the matters you have testified to here in Court?

A. No.

Mr. Dougherty: That is all.

Redirect Examination

Mr. Ross:

Q. There has been some confusion, Mr. Caskey, on Defendant's Exhibit B. You stated, did you not, that this was a commission ledger?

A. Well, it is a—— you can call it a commission ledger, but it is, in other words, it is a credit ledger. It is the amount of money or the monies on any particular item that we would credit to him, rather than draw a check for any number of a hundred

(Testimony of D. F. Caskey.)

items due in a month. We would just throw it in an account and they draw on it at various times, [154] or once a month.

Q. Now, if any money had been sent in by Mr. Rogers in payment of the premiums he had collected on policies, which he had written, would they be noted in this ledger?

A. Yes, they would be right in there. The commission that he is entitled to for premiums that he collected or that were collected would be in the right-hand column, would be in the credit column. The amount of commission he is entitled to would be in there.

Q. Is an agent entitled to a commission before he has paid in any premiums?

A. Well, I don't see how you can pay a commission on something that is not paid on any premium. There can't be any commission.

Q. Judging by the fact that the first entry on this ledger here is February 8th, which is ten days after Mr. Rogers death, do we assume from that that no premiums had been collected on any of his business until that time?

A. No premiums had been collected by the company on any of his business until the day of that first item. We had received no remittance from Mr. Rogers during his lifetime at all.

Q. So the first commission earned by Mr. Rogers would be sometime after his death?

(Testimony of D. F. Caskey.)

A. Would be that date there, right there, February 8th, if that is what it is. [155]

Q. Does the company have any record of premiums which Mr. Rogers collected and does not send in? A. Would we know?

Q. Would you know about it?

A. We would know—well, that report that you were discussing there is sent to them on the 15th of every month and it is sent to them for that purpose, in order to get their signature, in order to get their statements over their signature, and as I say, I audit that report and if it does not agree with the record, why, we take it up with them, but if they were to falsify that report I would have no way of knowing unless I went out to investigate and check up on the policy-holders.

Q. You mean, speak to the actual applicants?

A. Yes, call on the policy-holders, which we do very infrequently.

Q. Looking at this Exhibit A, we see that prior to his death Mr. Rogers had written up 30 or 40 policies? A. Yes.

Q. And from this it appears that he had sent in no money on any of those policies?

A. Yes, and the records of the policy register shows no premiums were ever sent in.

Q. How did it happen that those entries were made, how were these premiums collected?

A. Well, Mr. Lindberg called on all those policy-holders [156] and a great many of them, I have

(Testimony of D. F. Caskey.)

evidence there, I saw it, were policies that had been delivered and in the possession of the policy-holders. They had paid the money but we have never seen it, and a great many of those, or rather all of those credits there, all of those premiums were collected. I collected them there by letter or Mr. Lindberg called on them personally and got their remittance.

Q. Now, where Rogers collected the premium and did not send it into the company, did you offset the amount owing to the company against subsequent collections?

A. Any credit that an agent may accrue is first lien on it, that is, any indebtedness to the company. In other words, if there is any indebtedness we confiscate whatever indebtedness there is and take care of the collections.

Q. When an agent delivers the policy to an applicant and receives cash, does he give the applicant any form of receipt for the policy?

A. Well, he is not required to because the policy itself is a receipt for the payment for the first premium. There is no necessity for giving the receipt.

Q. The policy itself is a receipt for payment of the first premium. A. It states it is.

Q. And is an agent permitted to deliver a policy as a receipt without making some sort of an arrangement for the payment of premium? [157]

A. No, he is not.

(Testimony of D. F. Caskey.)

Mr. Dougherty: May I ask to hear that question read?

(The question was read by the Reporter.)

Mr. Ross: Referring to the books of the company; that is, Defendant's Exhibits A and B, could you state whether or not at the time of Rogers death, the New York Life Insurance Company was indebted to him in any amount?

The Witness: No, they were not.

Q. And you reached that conclusion by reference to what entries?

A. By the fact that we had never seen any money from him and this is the first—February 8th was the first entry we had and that would be substantiated by that entry, that policy you can find right here. You can find it in his policy register, that the first premium was reported to this office on February 8th. It would be shown right here if you want to go to the trouble to find it. On February 8th you will find it through the register account and that is the first entry we received, and every entry in this premium payment column will be subsequent to February 8th. There could not be any before that.

Mr. Ross: That is all.

Recross-Examination

Mr. Dougherty:

Q. Now, the agent may collect premiums, may he not? [158]

(Testimony of D. F. Caskey.)

A. The first premium only, represented by the policy.

Q. He may collect the first premium?

A. Yes, sir.

Q. And if his commission on that premium equals the premium, he does not remit, does he; he remits only the net premiums?

A. You said if the commission equals it?

Q. Well, if he collects the premium——

A. He collects the premium.

Q. He collects the premium and it is less or does not exceed the commission which he is entitled to, he may retain that, may he not?

A. No, no. No. I think you are a little confused there. He collects the premium——

Q. Yes?

A. And whether he collects the whole premium or part premium, is that what you mean? He can't retain anything, any of the collection he makes until he pays us the net premium. Illustrate it this way: A \$50.00 premium, if his commission is \$20.00, well, it doesn't make any difference to us whether he collects \$35.00 or thirty, we get the \$30.00.

Q. Well, all that you require him to transmit of the first premium is the net to you?

A. That is right.

Q. That means the net? [159]

A. Less the commission.

(Testimony of D. F. Caskey.)

Q. So he may retain his commission out of the premiums that he collects?

A. Well, in other words—— we will just answer this by saying that what we want is the net premium.

Q. Now, Mr. Caskey, your agents usually are used to collect notes received in payment for the premiums, are they not?

A. Well, we don't use them to collect notes, because we have nothing to do with the notes. The notes and theirs and payable to them. They can't be paid to the New York Life.

Q. They cannot?

A. We do not accept any notes.

Q. You look to the agent?

A. The agent looks to himself. We don't look to the agent at all.

Q. Now, on those premiums you say have been collected. Were any of the premiums represented by notes?

A. I imagine so. Some of those were collected?

Q. Yes? A. Oh, yes, I imagine so.

Q. Then you do collect notes for premiums?

A. Yes, sir; because the man was dead.

Q. As a matter of fact, agents frequently turn in notes and you collect it, don't you? [160]

A. Oh, no.

Q. You never collected it?

A. No, sir; just the opposite. We have nothing to do with it.

(Testimony of D. F. Caskey.)

Q. Well, if the note was made payable to Mr. Rogers, how does it come that you collected it?

A. Mr. Rogers had died. It was either pick up the policy or collect the note and we wrote to the people and asked them did they want to pay the note or did they want to pay the policy. Some people returned the policy and some of them paid the note. It was only, merely that we were attempting to collect the premium because it is a matter of business, that is all. We are in the business of selling insurance.

Q. In other words, after Mr. Rogers passed away it was purely a matter, a voluntary matter with the policy-holders whether they paid it or not?

A. That is right.

Q. You made no effort to make any collections?

A. Yes, we just told you we did.

Q. On these notes? A. Yes.

Q. On the notes? A. Yes.

Q. On the notes? A. Yes. [161]

Q. I hand you—— may this be marked for identification?

(Thereupon the document was marked Plaintiff's Exhibit 4 for identification.)

Mr. Dougherty: I hand you Plaintiff's Exhibit 4 for identification, Mr. Caskey, and ask you if you saw these notes represented by that exhibit?

The Witness: You mean after his death?

Q. Yes?

(Testimony of D. F. Caskey.)

A. I would not know whether I saw them or not. You will remember, I see hundreds of those things a year. I would not even remember the years, but I can look into the records of the policies he wrote and tell you whether or not these are the policy-holders. I can't remember hundreds of notes a year. I will imagine I did see the notes. If he wrote the policy-holders by that name and those notes were in his possession after his death, I imagine our correspondence will show where we wrote to those people and asked them if they would not pay the premium.

Q. So had Mr. Rogers lived, he would have—— it would have been his privilege and duty to have collected them?

A. And his duty to collect them, yes, sir. We had nothing to do with them.

Q. These policies, then, represent the sales that he had made of policies from your company?

A. Well, I imagine it represents the policies that he delivered, yes, sir. [162]

Mr. Dougherty: We offer this in evidence.

Mr. Jenckes: Are those offered in evidence?

The Court: Yes.

Mr. Dougherty: I beg your pardon, I didn't show them to you.

Mr. Ross: We object to this, your Honor. We don't see any purpose of this whatever, wholly immaterial.

(Testimony of D. F. Caskey.)

The Court: Well, they have not been identified yet.

Mr. Dougherty: Well, I think the witness has said that they are notes that were received by Rogers from policy-holders.

The Court: Well, he said he imagined they were. Do you know whether they are?

The Witness: I could not tell, your Honor, whether they are. I can take the record and check the notes against the ledger and see.

Mr. Dougherty: Will you please do that, then?

The Court: I will sustain the objection. Wasting time.

Mr. Dougherty: May this be marked?

(The document was marked Plaintiff's Exhibit 5 for identification.)

Mr. Dougherty: I hand you Plaintiff's Exhibit 5 for identification, Mr. Caskey, and ask you if you saw that before?

The Witness: Yes, I remember something about that. I remember—I have seen that. [163]

Q. That came into your office?

A. Well, it was in the office. Whether it was in my office or Mr. Lindberg's office, I don't know. My memory on that is, that that was in Mr. Lindberg's office. I could not testify to that. I have seen it. I know there was some sort of a deal like that with Mr. Clem.

Q. You do remember seeing this in your office?

A. Yes, I have seen a document like that and it

(Testimony of D. F. Caskey.)

must have been that, because I knew there was some sort of a deal between them, so I'd say I saw it.

Mr. Dougherty: I offer it in evidence as Plaintiff's Exhibit 5.

Mr. Ross: We object to this, your honor. I don't know what bearing it has. It is supposed to be an assignment of future commissions.

Mr. Dougherty: We propose to show that it was a part of the transactions between Mr. Rogers and the company and Mr. Clem, who will shortly be called as a witness, and I am identifying it by this witness as being an order delivered to his company.

The Court: Well, I know, but what difference does it make?

Mr. Jenckes: Is it offered in evidence?

Mr. Dougherty: It is.

Mr. Jenckes: Well, our same objection goes to the letter that we had this morning, I think, to the other [164] testimony.

The Court: Well, I assume you will attempt to connect that up?

Mr. Dougherty: Yes, I had just stated——

The Court: All right, the objection will be sustained.

Mr. Dougherty: No further questions.

The Court: That is all. Do you have anything further?

Mr. Ross: That is all.

Mr. Jenckes: Can Mr. Caskey be excused?

The Court: As far as I am concerned, he may.

Mr. Dougherty: As far as we know, I suppose we can call him.

Mr. Ross: Oh, yes. The defendant rests, your Honor.

The Court: Do you have any rebuttal?

Mr. Connor: Yes, your Honor. [165]

In Rebuttal

Mr. Dougherty: Call Mr. Davis.

BARTO C. DAVIS

was called as a witness in rebuttal for plaintiff, and being first duly sworn testified as follows:

Direct Examination

Mr. Dougherty:

Q. Will you please state your name and place of residence? A. Barto C. Davis.

Q. Where do you live, Mr. Davis?

A. I live at 17th Avenue and Camelback Road, Phoenix.

Q. What is your occupation?

A. Life insurance, Northwestern Life Insurance.

Q. Were you ever employed by the New York Life Insurance Company as an agent?

(Testimony of Barto C. Davis.)

A. Yes.

Q. When you speak of your present employment being life insurance, you mean that you are acting as agent for this company now employing you?

A. That is true.

Q. And previous to that time you worked with the New York Life?

A. That is true.

Q. For how long? [166]

A. From 1927 to approximately 1931.

Q. And did you ever work in the office, or was your work entirely in the field?

A. In the field.

Q. Are you familiar or were you familiar with the office practice of the New York Life during the time you were in their employ?

A. Yes.

Q. And were you familiar with the manner in which they handled—that is, the manner in which it handled policies; that is, the manner in which the policies were handled out of the Phoneix office?

A. My own personal ones, yes.

Q. And in that practice did you sell policies deferring the payment of premium, or did you always get cash?

Mr. Ross: We object to that, your Honor. He has testified he was employed by the New York Life in 1927 to 1931, over ten years ago. That fact would have no bearing on this jury, it is not involved here.

The Court: No, because this manager has only

(Testimony of Barto C. Davis.)

been here for a few years and maybe the practice has changed.

Mr. Dougherty: Well, I think I can qualify that. Is the practice now—— do you know whether or not the practice of the New York Life Insurance Company with respect to that point is the same now as it was when you worked there?

The Witness: According to the policies, yes.

[167]

Q. And under that practice, was the first premium always paid in cash before the policy was delivered?

Mr. Jenckes: Just a moment. If your honor please, we would like to ask this witness a few questions *voir dire*.

The Court: Yes.

Mr. Jenckes: Mr. Davis, you stated that you know that the policies of the New York Life Insurance Company are the same today as are or were at the time you were working for them?

The Witness: That is right.

Q. Upon what do you base that statement?

A. Upon my actual competition with the New York Life of the past and of the present, the way I issued these when with the New York Life Insurance Company and the way we handled our note settlement as of the present contract. If I may define myself more clearly, I will explain it.

Q. Yes, go ahead?

(Testimony of Barto C. Davis.)

A. When I was in business with them, we write a case of life insurance——

Mr. Jenckes: Just a minute, Mr. Davis. What I am trying to find out is why you know at this time that the practice of the New York Life Insurance Company is the same as it was then?

The Witness: Well, the policies haven't changed a bit and they are very definitely stated in their contracts. I have had a number of competitive cases during numerous times, [168] and through note settlement there is no difference in it. My actual practice with experience on competition, it is no different.

Q. What do you mean by "experience on competition"?

A. I mean in cases I have come in competition with the New York Life Insurance Company.

Q. In other words, you are basing your opinion upon the fact that some prospect that you were working on told you that he took out some insurance?

A. No, I mean this, Joe, that it says—— pardon me—— it says definitely in the contract of the New York Life that the premiums shall be paid in cash. If a note is taken by the agent at the time, by the New York Life, the man is not protected. His life is not protected in the event of death while that policy is going to the home office and returned. If he should be killed, he is not protected. It protects solely the agent. If the policy is delivered actually

(Testimony of Barto C. Davis.)

in the hands of the branch office, he is then protected. We use that as our——

Q. In other words, Mr. Davis, as I gather it, you are attempting to give some sort of a legal conclusion as to the effect of those contracts, is that correct?

A. I am not giving any legal effect, though we used that as a remunerative basis for settlement.

Q. How do you know that the contracts of the New York Life Insurance Company are the same today with respect to its [169] selling and handling policies as you did then; that is, from your personal knowledge?

A. Well, from my personal knowledge, as to that, Joe, I could not say, only through their contract reading.

Mr. Jenckes: Well, if your Honor please, we renew our objection to any testimony——

The Court: All right.

Mr. Dougherty: May I question him further. You say through their policies. Just what do you mean by that?

The Witness: From the life insurance company's policies written by the New York Life.

Q. You are familiar with the form of their policy? A. Yes.

Q. In similar cases?

A. That is the policy——

Q. That one you saw?

A. Ordinary life, or whatever it may be. That is what I am referring to.

(Testimony of Barto C. Davis.)

Q. And you have had occasion to compete with their agents in the field? A. That is true.

Q. And do you have occasion to know what their practice is with respect to the payment of premiums?

A. Well, at the present time I have not conferred or know anything about the practice at the office at the present time. [170]

Q. Do you know what the agents are doing in the field?

A. I do know what the agents are doing in the field, yes.

Mr. Jenckes: I'd like to ask a few more questions.

The Court: Well, he said he doesn't know anything about it. Get somebody that knows something about it. I don't want to hear any more from this witness. He said he doesn't know. Why waste time back and forth, back and forth?

Mr. Dougherty: Have you ever brokered through the New York Life Insurance Company?

The Witness: Yes, I have brokered business with them.

Q. Recently? A. Yes.

Q. Within what period of time?

A. Well, December, I believe it was.

Q. Of 1940? A. That is right.

Q. What was their practice then with respect to premiums?

(Testimony of Barto C. Davis.)

A. The premiums I had was purely cash. I don't know what their practice was.

Q. That was a brokerage transaction?

A. That is right.

Mr. Dougherty: You may step down as far as we are concerned.

(The witness was excused.)

The Court: Well, it is ten minutes to four now. We [171] will suspend until ten in the morning, gentlemen. Keep in mind the Court's admonition.

(Thereupon a recess was taken at 3:50 o'clock P. M. of the same day.)

10 o'clock A. M., April 23d, 1941, all parties as heretofore noted by the Clerk's record being present, the trial resumed as follows:

The Court: You may proceed.

Mr. Dougherty: Call Mr. Clem.

STANLEY CLEM

was called as a witness on behalf of plaintiff in rebuttal, and having been first duly sworn, testified as follows:

(Testimony of Stanley Clem.)

Direct Examination

Mr. Dougherty:

Q. You may state your name and place of residence, Mr. Clem?

A. Stanley Clem. 26 East Ashland, Phoenix.

Q. What is your business?

A. Lumber business.

Q. And how long have you lived here?

A. Since 1936. [172]

Q. Have you been in the lumber business during all that time? A. Yes, sir.

Q. Were you acquainted in his lifetime with Zeno A. Rogers? A. I was.

Q. How long had you known him?

A. I think I met Mr. Rogers the latter part of 1938.

Q. Are you acquainted with Mr. Lindberg of the New York Life, who sits here?

A. I only met him once.

Q. Now, will you state whether you had a conversation on or about October 28th, 1939, with Mr. Rogers and Mr. Lindberg? A. I did.

Q. Where did you have that conversation?

A. Well, a personal conversation was up in the Title and Trust Building in the New York Life Insurance Company office.

Q. And who was present?

A. Mr. Rogers and Mr. Lindberg.

Q. Mr. Rogers and Mr. Lindberg? A. Yes.

Q. Will you state what that conversation was?

(Testimony of Stanley Clem.)

Mr. Ross: Just a minute. Your Honor, before we go into this conversation with the deceased, could we have an [173] offer of proof in the absence of the jury to determine whether or not it is the same matter we went through yesterday?

The Court: Well, Mr. Lindberg was not present in the conversation that was sought to be brought out yesterday, but we will hear what it is. Go out in the hall, gentlemen.

(Thereupon the jury was excluded from the court room.)

Mr. Dougherty: Now, if your Honor please, we avow that this witness, if questioned, if we are permitted to question him, will testify that he participated in this conversation in which Lindberg was a party and it had to do with Mr. Rogers employment as a salesman. In order to effect the employment of Rogers as a salesman, it was necessary that he be advanced living expenses for himself and his family, and in response to that conversation, Mr. Lindberg or Mr. Rogers agreed to re-pay a loan of \$75.00 that Mr. Stanley Clem was to make to him, re-pay it out of his commissions, and that Mr. Lindberg agreed to that and in accordance with that Mr. Lindberg drew up an order on the company and gave it to Mr. Rogers for Mr. Clem's subsequent approval, and Mr. Clem approved it and it was—and, subsequently, that order was acknowledged and recognized by the company, and

(Testimony of Stanley Clem.)

that in subsequent conversation the matter was discussed and at that conversation Lindberg discussed the fact that they had given Zeno Rogers the policy which was to be paid out of his commissions to be earned, [174] and that he asked Mr. Clem here to postpone his payments until such time as the company had first been paid.

The Court: All right, call in the jury.

Mr. Jenckes: Before they are called in, I wonder if we could cross-examine Mr. Clem on voir dire?

Mr. Dougherty: There is no occasion for voir dire.

The Court: You can't cross-examine the witness until he has testified.

Mr. Jenckes: Well, you can object——

The Court: Well, you can object to the offer.

Mr. Jenckes: We will make an objection to the proffer on the grounds it is irrelevant, incompetent and immaterial and has no bearing upon the issues in the case and there is no showing in the record on the fact that Mr. Lindberg was there, that he was authorized and qualified or acting within the scope of his employment with the company.

The Court: All right, the objection is overruled. Call the jury.

(Thereupon the jury returned into the court room and resumed their places in the jury box.)

Mr. Dougherty: Will you read the last question?

(Testimony of Stanley Clem.)

(The question was read by the Reporter.)

Mr. Dougherty: I have asked you to state what the conversation was between yourself, Mr. Lindberg and Mr. Rogers on the occasion concerning which is October 28th, 1939?

The Witness: Well, it was relative to a loan which [175] Mr. Rogers wanted to obtain from me in order to carry him over until such time as some of his commissions had accumulated I think one-third of his commissions had accumulated to repay my loan, and I was anxious to see Rogers get employment and I agreed that if the New York Life Insurance Company would guarantee me to repay this loan out of his commissions, that I would advance to Mrs. Rogers \$15.00 a week until the \$75.00 had been used up, and I wanted some evidence to show that I would have this money coming out of his commissions, so Mr. Rogers brought down to me an assignment of his commissions—

Mr. Jenckes: Just a minute——

The Court: Just a minute. You are supposed to detail the conversation that you had. You haven't done that yet. Strike that testimony.

Mr. Dougherty: Yes. I hand you now——

The Court: Well, let him answer the question you asked him. You asked about the conversation. He has not told of any conversation.

Mr. Dougherty: Will you read the last answer.

(The last answer was read by the Reporter.)

(Testimony of Stanley Clem.)

Mr. Dougherty: Mr. Clem, will you please state as nearly as you can remember what the conservation was which took place between yourself, Mr. Lindberg and Mr. Rogers?

The Witness: Well, I think it would be probably impossible for me to state the exact words that we used. [176]

The Court: You don't have to state the exact words, just to the best of your recollection.

The Witness: I said to Mr. Lindberg that I was willing to advance to Rogers up to \$75.00 if I was assured that the money would be repaid to me. Mr. Lindberg, of course, could not say that the money would be repaid to me out of anything except Rogers' commissions, or whatever you call it, earnings out of the sale of life insurance.

Mr. Dougherty: Well, just state the language as closely as you can—— just how he said it?

A. Well, I said, "I am perfectly willing to advance to Mr. Rogers \$75.00 if I am reasonably assured that it is going to come back." Mr. Lindberg told me that he was rather impressed with Mr. Rogers' personality and he believed he could sell insurance, and I told Mr. Lindberg, "I think he could too. He is a very good salesman". Mr. Rogers said to me that he would be willing to give an order on the New York Life Insurance Company for the repayment of this loan. I was to pay it, as I said before, \$15.00 a week and give it to his wife. The gist of the conversation was just as I have said, that the

(Testimony of Stanley Clem.)

money would be re-paid to me as commissions had accrued to Rogers on the sale of life insurance.

Q. Yes. Now, after this — this conversation took place at the company office here in Phoenix?

A. Yes, at the company office. [177]

The Court: When was that conversation?

The Witness: The latter part of October.

Q. Anybody present but you three?

A. No.

Mr. Dougherty: I think I asked that question as to who was present. Later on, immediately following that, did you have any further conversation with Mr. Lindberg?

The Witness: Not except over the telephone.

Q. Well, over the telephone, did you have any further conversation with him?

A. Not until after Mr. Rogers had come to my office with this copy of the order to the New York Life Insurance to pay me the money.

Q. And Mr. Rogers, as a consequence of the conversations you had had with Lindberg and he—— him, brought to you an order?

A. That is right, a copy, I think, of the order. It may have been the original, but I don't believe it was.

Q. I want to show you Plaintiff's Exhibit 5 for identification and ask you if that is the order that Rogers brought to you?

A. That is the one, yes.

Q. Now, state what conversation, if any, you had

(Testimony of Stanley Clem.)

over the 'phone with Mr. Lindberg concerning this order?

A. Mr. Lindberg called my on the telephone. It was either the same day or the morning of the following day, and [178] asked me if the order was satisfactory to me and, of course, we had a conversation then as to Mr. Rogers ability and my experience with him which had nothing to do with this.

Q. And this order was left with you?

A. It was left with me.

Q. Mr. Lindberg—— who prepared the order, do you know?

A. I would not know that. I supposed that someone in the New York Life Insurance Company prepared it.

Mr. Dougherty: We now offer this in evidence, your Honor.

The Court: It may be received.

(The document was received as Plaintiff's Exhibit 5 in evidence.)

PLAINTIFF'S EXHIBIT NO. 5

Phoenix, Arizona,
October 30, 1939

New York Life Insurance Co.
51 Madison Avenue
New York, N. Y.

Gentlemen:

This is to authorize you to pay to Mr. Stanley Clem, one-third of the commissions that accrue to

(Testimony of Stanley Clem.)

my credit until a total amount of \$75.00 has been paid to him.

Very truly yours,

Z. A. ROGERS

[Endorsed]: Pltfs Exhibit No. 5 Rogers vs. N. Y. Life Case No. Civ-146 Phx marked for identification Apr 22, 1941, admitted and filed Apr 23, 1941 Edward W. Scruggs, Clerk, United States District Court for the District of Arizona by Wm. H. Lovelless, Chief Deputy Clerk. [49]

Mr. Connor: Your Honor please, we would like permission to read this to the jury.

The Court: All right.

(Thereupon Plaintiff's Exhibit 5 was read to the jury by Mr. Connor.)

The Court: All right, proceed.

Mr. Dougherty: Now, after having received this, Mr. Clem, did you have any further conversation over the 'phone or otherwise with Mr. Lindberg concerning the Rogers matter?

The Witness: Yes. Sometime later than that, the latter part of December, as I recollect it——

Q. Let me first ask you this question: Did you receive any money as a result of this order?

A. No—— oh, you mean from the New York Life Insurance Company?

Q. Yes? A. No, sir.

(Testimony of Stanley Clem.)

Q. Nor from Rogers?

A. Not from Rogers, no.

Q. Now, I interrupted your answer. You had a conversation with Mr. Lindberg over the 'phone about the latter part of December, you say, of 1939?

A. Yes.

Q. And that was concerning the Rogers matter.

A. Yes.

Q. Will you state what that conversation was?

Mr. Jenckes: Just a minute. If your Honor please, could we ask a few questions on voir dire?

Mr. Dougherty: This has nothing to do with voir dire.

The Court: Counsel made a statement what he intended to prove.

Mr. Jenckes: No, no. This goes to the question of whether he was talking to Lindberg.

The Court: Go ahead.

Mr. Jenckes: Mr. Clem, how did you happen to have this telephone conversation; that is, did you call Lindberg or did he call you?

The Witness: Which conversation do you mean?
[180]

Q. The last conversation over the telephone that you are referring to in December?

A. I called Mr. Lindberg—I called for him and he wasn't in the office and I left word for him to call me and then he had returned my call.

Q. How did you happen to know it was Mr. Lindberg you were talking to?

A. That is what he said.

(Testimony of Stanley Clem.)

Q. It was just the fact that whoever called you said he was Mr. Lindberg?

A. That is right. He asked me if I called him.

Q. As far as you know, it might have been anybody else in the office up there?

Mr. Dougherty: We object to that as irrelevant, incompetent and immaterial. The man has testified that he put in a call for Lindberg and when Lindberg came in, he called him.

The Court: All right.

The Witness: That would have been possible.

Mr. Jenckes: Your Honor please, we object to any further testimony in connection with the telephone call on the grounds it is——

The Court: The objection is overruled.

Mr. Dougherty: You may state now what the conversation was, Mr. Clem.

The Witness: I began to wonder along about a month or [181] less whether or not Mr. Rogers was getting along all right, and he had written me a letter to be sure and send over to his wife some more money. I admit I had slipped about a week or so on it, and I then wrote him back a letter telling him I would like to have a report on how he was getting along and when I could expect the return of this money, and he wrote me back a letter——

Mr. Jenckes: Now, just a minute, we object to this.

The Court: All right.

Mr. Dougherty: Now, you are speaking of a con-

(Testimony of Stanley Clem.)

versation or some communications you had with Rogers. We are concerned here with the conversation you had over the 'phone with Mr. Lindberg.

The Witness: Oh! Well, I called Mr. Lindberg after I communicated with Mr. Rogers to verify what Mr. Rogers had said to me, that he could not pay this money until he had paid his premium on his life insurance, and Mr. Lindberg told me that Rogers had taken a life insurance policy with the company, but I need not be disturbed about the situation because Rogers had sold quite a lot of insurance and, as I recollect it, he said his premiums would run three or \$400.00 and that I need not be disturbed about it because the New York Life Insurance Company would see that I got my loan.

Q. Well, what was said about the policy, if anything?

A. He told me that it was true, that Mr. Rogers had taken out a policy with the New York Life Insurance Company. [182]

Q. And which was to be paid first, was anything said about it, the premium on that policy or your payments?

A. The premium on the policy had to be paid, as I understood, before I could begin getting my money out of it.

Mr. Jenckes: Your Honor please, we move to strike that last answer on the ground it is what he understood and not what was said.

Mr. Dougherty: In other words, you would not

(Testimony of Stanley Clem.)

receive out of his earnings any money on your account until the policy had been paid, or the premium.

Mr. Jenckes: Just a minute, we move to strike that.

The Court: That is your conversation and not Mr. Lindberg's.

Mr. Dougherty: No.

The Court: Let the witness testify.

Mr. Dougherty: Yes, I am quite willing to let the witness testify.

The Witness: Mr. Lindberg told me over the 'phone I would not get my \$75.00 back until Rogers had paid the premium on his policy. That is the exact conversation, I need not be disturbed about it because he had built up enough premiums there that I could not help but get my money.

Q. What is the reason—— what was your reason for calling Mr. Lindberg concerning——

Mr. Jenckes: Just a minute. We object to that on the grounds it is immaterial. [183]

The Court: Yes.

Mr. Dougherty: You may take the witness.

Mr. Ross: No questions.

Mr. Dougherty: That is all.

The Court: Stand aside. Call your next witness.

(The witness was excused.)

Mr. Dougherty: Mrs. Rogers.

LOIS ROGERS

was called as a witness in her own behalf in rebuttal, having been heretofore duly sworn testified as follows:

Direct Examination

Mr. Dougherty:

Q. Mrs. Rogers, about what was the date of your husband's funeral here in Phoenix?

A. On February 1st, 1940.

Q. Now, do I understand from your previous testimony that his body was brought from Fort Huachuca Hospital to Phoenix?

A. The body was turned over to the mortician in Bisbee and the mortician here received the body from the mortician there when he brought it back.

Q. Mr. Rogers, I understand, had been staying at the Page Hotel in Willcox, Arizona?

A. That is right. [184]

Q. Had you visited the hotel—— strike that. Did he have a room in that hotel?

A. Yes, he did.

Q. Had you visited the hotel or the room, or had you visited the southern part of the State between the time of his death and the time of his funeral?

A. No, I had not.

Q. You had not examined the contents of his room or any of his personal belongings?

A. No, I had not.

Q. Now, on or about that time; that is, directly after the funeral did you have occasion to go to Willcox?

A. Yes, I did.

(Testimony of Lois Rogers.)

Q. And with whom did you go?

A. I went with Mr. Lindberg and my elder son, Gale, and my sister-in-law, Mrs. Miller.

Q. How did you go?

A. We went by car, in Mr. Lindberg's car.

Q. Now during the trip to Willeox, did you have any conversation with Mr. Lindberg concerning this insurance policy involved in this action?

A. Yes, we did.

Q. Will you state as nearly as you can remember what that conversation was?

Mr. Jenckes: Just a minute, if your Honor please. Before she relates that conversation we wish to object to the [185] testimony upon the grounds that there is no evidence here that Mr. Lindberg, at that time at any conversation he might have had with Mrs. Rogers, was acting within the scope of his employment, no showing that any statements he may have made at that time would have been binding upon the New York Life Insurance Company.

Mr. Dougherty: We submit, your Honor, he was in continuous employment and this testimony is as relevant as any testimony could be. He was still the agency director and the manager of the insurance company in this State.

The Court: All right, go ahead.

Mr. Dougherty: Now, will you state what the conversation was?

The Witness: Well, I asked Mr. Lindberg for

(Testimony of Lois Rogers.)

the policy and he said I could not have the policy, that he had it. And I said, "Where did you get it?" He said, "I took it from his room along with other papers belonging to the company", and I said, "You had no right to do that; you did that against my instructions and against my telegram to the hotel to allow no one in that room until my arrival." He said, "I had the right because everything in the room pertaining to the company is now the property of the New York Life Insurance Company, therefore, I had the right to take it and I have it".

Q. Now, state what further conversation there was, if you had further conversation? [186]

A. Well, when I said he had no right to take that and he said he did have a right because it was company property, I said, "Well, isn't it true that you had an agreement of a credit arrangement between yourself and my husband to pay for this premium out of his accumulated earnings?" He said, "Yes, that is the way it was supposed to have been, but unfortunately he died before he was able to pay anything on it". And I said, "I still want the policy, I consider it my property". He said, "Well, I can't give it to you".

Q. He did not give it to you?

A. He did not give it to me.

Mr. Jenckes: Your Honor please, at this time we would like to move to strike all of this testimony upon the ground that the record affirmatively shows

(Testimony of Lois Rogers.)

here that Mr. Lindberg had no authority to extend credit on the issuance of policies, and anything he might have said to her in that respect is not binding upon the New York Life Insurance Company for that reason.

Mr. Connor: There is no such thing in the record, and furthermore——

The Court: Well, I will overrule it now. We can argue that later.

Mr. Dougherty: That is all.

The Court: Do you wish to cross-examine?

Mr. Jenckes: Just a minute, your Honor. [187]

Cross-Examination

Mr. Ross:

Q. Mrs. Rogers, what did Mr. Lindberg state regarding the payment of premiums on this policy?

A. He said—— well, I said, “I understood from my husband that you and he had an arrangement, an agreement to pay this premium out of his accumulated earnings”, and he said, “That was the way it was supposed to have been, but unfortunately he died before he was able to pay anything on it”.

Q. Did you ask Mr. Lindberg whether there had been any earnings on commissions?

A. Yes. I said, “Well, I understand that he was selling a lot of insurance”, and he said, “He is”. His words were, “He is a cracker-jack salesman, but”, he said, “sometimes they are slow coming in.”

(Testimony of Lois Rogers.)

Q. Did he explain to you why there had been no earnings?

A. I don't recall he did.

Mr. Connor: We object to that. I think that is immaterial.

The Court: She may answer.

The Witness: I don't recall that he did other than he said sometimes the premiums are slow coming in.

Mr. Ross: When he told you that Rogers was to pay the premiums out of future earnings, you did not question him regarding whether or not there had been such earnings turned [188] into the company? A. Yes, I did.

Q. And what was his reply?

A. He said there wasn't.

Q. He said there had not been any earnings to the company? A. As yet.

Q. Did he tell you that the premium had been paid? A. No, he did not.

Q. Did he tell you that it had not been paid?

A. Yes, he said that there had been nothing, he had been unable to pay anything on it before his death.

Q. Did he tell you that the policy was ever in force?

Mr. Dougherty: We object to that, calling for a conclusion of the witness. In the first place, it would be a conclusion of Lindberg's.

The Court: Yes.

(Testimony of Lois Rogers.)

Mr. Ross: The objection was sustained?

The Court: Yes. Is that all?

Mr. Ross: That is all.

(The witness was excused.)

Mr. Connor: Call Mr. Gale A. Rogers.

Mr. Dougherty: You Honor please, I have forgotten one question that I wanted to ask Mrs. Rogers concerning this exhibit here. I'd like to recall her to question her concerning this exhibit.

[189]

The Court: All right, we have this boy. You have been sworn?

GALE A. ROGERS

was called as a witness on behalf of plaintiff in rebuttal, and being first duly sworn testified as follows:

Direct Examination

Mr. Dougherty:

Q. Will you state your name?

A. Private Gale Rogers.

Q. You are the son of Mrs. Rogers who is the plaintiff in this case? A. Yes.

Q. And Zeno A. Rogers, deceased?

A. Yes.

(Testimony of Gale A. Rogers.)

Q. On or about the fore-part of February, 1940, did you accompany your mother and Mr. Lindberg, and I believe an aunt of yours on a trip from Phoenix to Willcox? A. Yes.

Q. In Mr. Lindberg's automobile?

A. Yes.

Q. State whether or not you heard any conversations between Mrs.—— between your mother and Mr. Lindberg during that trip?

A. Yes. [190]

Q. Will you state the relative positions in which you were seated; who was in the front seat and who was in the back seat?

A. Mr. Lindberg was driving and my mother was in the front seat.

Q. Will you try to speak a little louder?

A. I was in the back seat with my aunt, Mrs. Miller.

Q. Could you overhear the conversation taking place with your mother and Mr. Lindberg?

A. Yes.

Q. You say you did hear such conversations?

A. Yes, I did.

Q. Will you state as nearly as you remember what those conversations were, Gale?

A. Well, my mother asked Mr. Lindberg where the policy was. Mr. Lindberg said he had it, that he had taken it from my father's hotel room. My mother said he had no right to take that and Mr. Lindberg said he took it anyway, and then my

(Testimony of Gale A. Rogers.)

mother asked Mr. Lindberg if it wasn't true that my father was supposed to have paid the policy from his own earnings. Mr. Lindberg said, "Yes, that is the way it was supposed to have been," but my father died before any commissions could come in, and my mother asked Mr. Lindberg for the policy but Mr. Lindberg said he could not give it to her.

Mr. Dougherty: That is all. [191]

Mr. Ross: No questions.

(The witness was excused.)

Mr. Dougherty: May I recall Mrs. Rogers?

The Court: Yes.

LOIS ROGERS

was recalled as a witness in her own behalf in rebuttal, and having been heretofore duly sworn, testified further as follows:

Redirect Examination

Mr. Dougherty:

Q. Mrs. Rogers, I show you Plaintiff's Exhibit 4 and ask you to examine the different documents grouped in there; just look through them?

(The witness complies.)

(Testimony of Lois Rogers.)

Mr. Dougherty: Now, have you seen these papers before, these notes before?

The Witness: Yes, I have.

Q. These are promissory notes, and from whom did you receive them?

A. I received them from someone in the New York Life Insurance Company's office here in Phoenix.

Q. How did you receive them?

A. In a letter.

Q. They were mailed to you?

A. They were mailed to me with a short letter stating [192] they were notes that they had tried to collect on.

Q. You have since had them in your possession?

A. Yes.

Q. Have you ever collected on them?

A. No.

Q. Have you ever tried? A. No.

Mr. Dougherty: We offer these in evidence, your Honor.

The Court: For what purpose?

Mr. Dougherty: For the purpose of showing that he—— Mr. Rogers had premiums—— had commissions coming if these notes were enforced as they might have been by the company. They were taken from his possession, came into the possession of the company in some way and they held them and finally abandoned them, apparently, and turned them back to Mrs. Rogers.

(Testimony of Lois Rogers.)

The Court: Well, how do you know they could have been collected?

Mr. Dougherty: I don't know, but there has been no proof that they could not be.

The Court: Well, I don't think the burden is on the defendant.

Mr. Dougherty: On their face, they are an enforceable contract. That is one purpose. The second purpose, showing that they do take notes; that notes are a part of the credit [193] arrangement which the company makes.

The Court: That is all right. They are payable to Z. A. Rogers. How does the life insurance company collect these notes?

Mr. Dougherty: I think it has been testified by Mr. Caskey that they looked to the agent to collect the notes. Apparently it is just a mechanical arrangement whereby the agent takes the note for the benefit of the company, because ultimately the company must be paid as a result of that note. Those notes were taken for policies that were issued.

The Court: I know, but that was Z. A. Rogers.

Mr. Dougherty: True, but under Mr. Caskey's testimony——

The Court: After his death, how could the company collect these notes?

Mr. Dougherty: Beg pardon?

The Court: After his death, we all know that——

(Testimony of Lois Rogers.)

Mr. Dougherty: That is true, but they had them in their possession.

The Court: All right. Is there any objection?

Mr. Dougherty: I am not quite through.

Mr. Ross: We object, that it would in no way prove that commissions had been earned. It was a personal arrangement between Rogers and the debtors.

Mr. Dougherty: May I be heard further?

The Court: Yes, go ahead.

Mr. Dougherty: All right. I maintain——[194]

The Court: Let me talk a minute. How do we know what those notes were given for as far as those records are concerned? It might be borrowed money.

Mr. Dougherty: No, Mr. Caskey testified——

The Court: He testified about these notes?

Mr. Dougherty: Yes, he testified the same notes were in the office of the New York Life.

The Court: Well, I am not going to argue with you. The objection is sustained. That is all.

Mr. Dougherty: That is all, Mrs. Rogers.

(Thereupon the witness starts to leave the witness stand.)

Mr. Dougherty: Just a moment, just step back there a moment.

Q. Do you have the letters accompanying those notes or do you know where they are?

A. Yes.

Q. I hand you here what appears to be a letter

(Testimony of Lois Rogers.)

from the New York Life Insurance Company by Mr. Caskey to you; two letters, and ask you whether you received those letters through the mail?

A. Yes, I did.

Q. And are those the letters by which these notes in Exhibit No. 4 were transmitted to you?

A. Yes, they are, contains a listing of each note by number. [195]

Q. Do you know the signature of Mr. Caskey?

A. Well, I have never seen him write his name. I suppose that is his signature.

Mr. Dougherty: Will you admit that is his signature, or will I have to call him?

Mr. Ross: Yes, we will admit that is Mr. Caskey's signature.

Mr. Dougherty: All right. We ask to have this marked for identification. I should have done it before.

(Thereupon two documents were marked Plaintiff's Exhibit 6 and 7 for identification.)

Mr. Dougherty: We now offer in evidence Plaintiff's Exhibits 6 and 4 for identification, for among other purposes, showing the fact that the company acts through its agents, accepts notes for payment of the first premium accruing on policies sold by the agents.

Mr. Ross: We object to it, your Honor. There is no relevancy whatever to this action, both the letters or the notes.

Mr. Jenckes: And we further object on the

(Testimony of Lois Rogers.)

ground that the letters don't purport or can't prove the things that they were offered to prove, because they had nothing to do with the company.

Mr. Dougherty: Oh, yes, they identify the notes fully. The letters and the notes check.

The Court: Well, I don't, I can't see the materiality [196] of it.

Mr. Dougherty: We feel, you Honor——

The Court: There isn't any question before the Court or the jury as to whether or not the company did allow their agents to accept notes for first premiums. The question here is whether the deceased was extended credit by the company to take care of his premiums. That is a different proposition.

Mr. Dougherty: Well, there are two ways in which that might be established; one, by special arrangement and the other one by the general business practice of the company. Now, we have maintained——

The Court: I know, but this is not the same thing. I don't think it is proper. The objection will be sustained.

Mr. Dougherty: That is all, Mrs. Rogers.

(The witness was excused.)

Mr. Dougherty: The plaintiff rests.

The Court: Anything further?

Mr. Ross: Yes. [197]

In Surrebuttal

Mr. Ross: Call Mr. Lindberg, please.

ARTHUR F. LINDBERG

was called as a witness on behalf of defendant in surrebuttal, and having been heretofore duly sworn, testified as follows:

Direct Examination

Mr. Ross:

Q. Mr. Lindberg, I hand you Plaintiff's Exhibit 1 and ask you to study it and note where Mr. Rogers name appears in the columns on the sheet, and tell us whether or not the appearance of his name in that exhibit indicates that he had earned any commissions with the company or sent in any premiums to be collected?

Mr. Dougherty: We object to that as not being proper at this time. That is a part of your principal case. It is not rebuttal.

The Court: Well, is that the document that shows——

Mr. Dougherty: It is the circular that was sent out.

The Court: Probably it is not admissible anyway. You can take a dozen applications and never write one policy. If I hear any more about it I will strike it from the record.

Mr. Ross: Was the question answered or shall we strike the question and answer? [198]

The Court: Oh, he may answer.

The Witness: His name only appears in the column showing written applications and, of course, there is no commission earned until the policy is delivered and paid for.

(Testimony of Arthur F. Lindberg.)

Mr. Ross: Mr. Lindberg, when did you last see Mr. Rogers alive?

A. On January 21st, 1940.

Q. Where did you see him?

A. In his hotel room at Willcox, Arizona.

Q. Was anyone present at that time?

A. No, just Mr. Rogers and myself.

Q. Did you at that time know whether Mr. Rogers had applied for a policy with the company?

A. Yes, I knew he had applied for a policy.

Q. Did you know whether he had paid the first premium to the company on the policy?

A. No, I knew he had not, because he had had no—I get a daily report of all paid business and we had received no—this report had never shown his name as containing any paid business.

Q. Did you know at that time whether the policy had been forwarded to Mr. Rogers.

A. No, I did not.

Q. Did Mr. Rogers mention the insurance policy to you at that time?

A. Yes, he asked me, "What about my own policy?" He [199] said, "How long can we hold that without sending it back for cancellation?"

Q. And will you tell us what the conversation was?

A. Well, I told him that if the policy was not settled for within 30 days from the time we received it at the branch office from our home office, that before it could be then delivered he would have an-

(Testimony of Arthur F. Lindberg.)

other examination at his own expense. "Well," he said, 'he would not worry about that, because he had given the doctor or the examiner in Willecox so much business he knew the doctor would make his second examination in that event without any extra charge,' and he said, 'it would probably be another 30 or 60 days before he would be in a position to pay the premium on it.'

Q. When you learned of Mr. Rogers death, did you communicate with Mrs. Rogers.

A. Mrs. Rogers communicated with me. I received a telegram on Saturday, January 27th, that he had been injured in an automobile accident and then I immediately communicated with her and informed her of what had happened and the following day, which was Sunday, January 28th, she 'phoned me and advised me of his death.

Q. At that time was the insurance policy in question mentioned?

A. Yes. Mrs. Rogers asked me what about the policy that Mr. Rogers applied for, and I replied that the policy had been issued, but that he had made no payments on same and [200] for that reason it was not in effect.

Q. Was anything further said at that time regarding the policy?

A. Well, in fact, I told her that in the case of a policy on the agent's own life, we didn't even send the policy to the agent, it is held in our office——

(Testimony of Arthur F. Lindberg.)

Mr. Dougherty: Wait a minute, will you read the last question?

(The last question and answer was read by the Reporter.)

The Court: Go ahead, is that all?

The Witness: That was the full conversation relative to the policy as I recall it.

Mr. Ross: When did you next talk with Mrs. Rogers after that?

The Witness: In regard to the policy?

Q. No, when did you see her next?

A. I saw her on the following Monday evening prior to my making a trip to Willcox. She was having dinner at a friend's house that evening and I went to see her at that time to tell her I was going down to Willcox to get the company's papers that were in Mr. Rogers' room, and my purpose in going to see her was to see if she wanted me also to bring back his personal effects, his clothing and things of that kind that were in the hotel room, and she told me, 'No, I should leave those, that she would go down and get [201] those things herself'.

Q. After the funeral, did you make a trip to Willcox with Mrs. Rogers, her son and her sister?

A. Yes, I did, on February 2d.

Q. Did Mrs. Rogers at any time on that trip ask you about this policy?

A. No, she did not, outside—— the only discussion there would have been on that trip was, I might have perhaps said, "It is unfortunate that

(Testimony of Arthur F. Lindberg.)

the policy that he had applied for in our company was not also in effect". There was considerable discussion about the policy he held in another company.

Q. Did you discuss whether or not Zeno Rogers had earned any commissions——

Mr. Dougherty: Just a moment, we object to that line of questioning as leading. You have already asked this witness several times what the conversation was and apparently when you don't get the response you want, you ask him further. We object to it as leading.

The Court: It is not confined to that, counsel, alone. Go ahead.

(The question propounded by Mr. Ross reading: "Did you discuss whether or not Zeno Rogers had earned any commissions——" was read by the Reporter and the question was finished as follows:)

Mr. Ross: ——and that any money was owing by the [202] company?

The Witness: I don't think there was any discussion of that nature on that trip, because I had had several telephone conversations prior to Mr. Rogers' death, in which she had inquired of me as to when he was going to get some commissions, and I told her that while he had written several policies, none of them had been paid for and, therefore, no commissions were due.

Q. Did you discuss any other insurance policies on that trip?

(Testimony of Arthur F. Lindberg.)

A. Yes, we discussed the policy that Mr. Rogers held in another company.

Q. What was the substance of the conversation?

Mr. Connor: We object to that as being immaterial. What has another policy got to do with this case? It is immaterial, irrelevant and incompetent.

The Court: Well, I don't think it would have anything to do with this case.

Mr. Ross: Well, we are merely showing there was a question as to whether or not the other policy would be paid because of a possible suicide, and the question in regard to the New York Life policy was never mentioned and brought up.

The Court: That is what he said. He said there wasn't very much said about this policy. What was said about another policy and a hundred other things that they [203] talked about on the trip would not be material.

Mr. Ross: Did Mrs. Rogers mention this insurance policy to you at any time subsequent to this trip to Willcox?

The Witness: The policy on Mr. Rogers own life you are referring to?

Q. I am referring to the policy on Rogers life?

A. Yes, she came into my office, I believe, in the early part of March, and asked me, "Where is the policy on Mr. Rogers life, I am going to bat on it?"

Q. And what was the substance of your conversation with Mrs. Rogers?

A. I replied to her question that there was no

(Testimony of Arthur F. Lindberg.)

one felt any worse about the policy not being in effect than I did, but the fact remained that there had been no premium paid and, therefore, the policy was not in effect, and I told her that if she did intend to take it to Court, I would advise that she take it on a basis where the attorneys in question would have no fee unless they were able to collect on the suit. That was my suggestion to her and that ended our conversation in regard to the policy.

Q. Did she ask for the policy at that time?

A. She did not ask for the policy, she asked, "Where is the policy, I am going to bat on it?"

Q. Did she ask at that time or on the trip to Willecox what she would have to do to collect on the policy? [204]

A. She did not.

Q. Do you now, or have you ever had authority as an agent for the New York Life Insurance Company to enter into any sort of a credit arrangement regarding the payment of premiums issued on insurance policies?

Mr. Dougherty: We object to that as calling for a conclusion of the witness. We do not think that the power of authority or privileges or scope of authority of the agent can be testified to directly by himself and that is not the way in which the powers of an agent is established.

The Court: He may answer.

The Witness: I have no authority whatever to extend credit arrangements of any kind to anyone.

(Testimony of Arthur F. Lindberg.)

Mr. Ross: Have you ever entered into such a credit arrangement? A. I have not.

Q. Did you ever enter into such a credit arrangement with Rogers? A. I had not.

Mr. Ross: That is all.

The Court: We will take our morning recess now, gentlemen. Keep in mind the Court's admonition.

(Thereupon a short recess was taken, after which all parties as heretofore noted by the Clerk's record being present, the trial resumed as follows:)

Mr. Dougherty: Mr. Lindberg, I think was on the stand. [205]

Mr. Jenckes: We have nothing further on direct.

ARTHUR F. LINDBERG

resumed the witness stand and testified further as follows:

Cross-Examination

Mr. Dougherty:

Q. Mr. Lindberg, directing your attention now to the period during which Mr. Rogers was employed, I want to ask you if, in all instances where policies were written, the premium—the first premium on the policy was prepaid before the policy was delivered?

A. No, as has been brought out in testimony before.

Q. Your answer to that question is "no"?

(Testimony of Arthur F. Lindberg.)

A. No. Sometimes policies are delivered without the premium being paid in cash.

Q. So that you do deliver policies on credit?

A. To people other than agents of the company.

Q. You just made your own rule along that line?

A. That has been the company's established rule for the 17 years——

Q. Did you ever call Mr. Rogers' attention to any rule of that kind? A. Yes, definitely.

Q. You did? When and where?

A. One time at Willcox when I saw him on the 21st day [206] of January.

Q. Did you call Mr. Clem's attention to that when you had a conversation with him?

A. I had no conversation with Mr. Clem regarding Mr. Rogers' policy at any time.

Q. In general, when he called you up, you informed him, did you not, that his re-payment would have to be deferred until the policy——

A. No, I did not.

Q. You didn't have any such conversation?

A. I had no such conversation with him.

Q. None at all, but you do take notes, then, in payment of premiums?

A. The agents are permitted to take notes payable to themselves when they deliver a policy to the applicant, other than an agent of the company.

Q. That is the arrangement you have, whereby you hold the agent responsible for the collection of the premium, isn't it?

(Testimony of Arthur F. Lindberg.)

A. Yes, that is correct. If the note is not paid by the applicant, the agent has to pay the note.

Q. Nevertheless, the policy is sold on credit?

A. You might call it that, as far as the agent is concerned. As far as the company is concerned—

Q. Yes. you say you didn't know, on the 21st of January, you didn't know that Mr. Lindberg had the policy? [207]

A. That Mr. Rogers had the policy?

Q. Or Mr. Rogers had the policy?

A. No, I did not. Had I known, I would have taken it back with me.

Q. You said you discussed the policy?

A. Yes.

Q. And it never occurred to you to ask where the policy was at the time?

A. I naturally assumed it was in the office as in all other cases on the policy on an agent's own life.

Q. You have complete control of the office, don't you?

A. Oh, no. I have—— I could not possibly perform my other duties if I had to check up and see where every policy was. We handle quite a few policies.

Q. You have general control of the office, do you not?

A. I am supervisor of the office. I do not have a great deal to do with the cashier's office. That is the cashier's position. He does a pretty good job of supervising it so I don't pay attention to it.

(Testimony of Arthur F. Lindberg.)

Q. The policy was sent out under Mr. Caskey's—

A. Or under his supervision.

Q. Did you inquire whether this policy had been sent to Mr. Rogers? A. No, I did not.

Q. Yet, you say you had a conversation with him on the 21st day of January, where the policy was discussed but you [208] did not question him as to where the policy was?

A. No. Naturally, I knew the policy had been issued and I assumed we were holding it in the office; that is, we usually did in a case of a policy on an agent's own life.

Q. You say you told him that?

A. The question didn't come up at that time.

Q. Notwithstanding you were discussing the policy, the question didn't arise where it was?

A. No.

Q. Are you familiar with the reports that come into your office from the agents, Mr. Lindberg?

A. I usually don't see those reports. They are handled by the cashier. I am familiar with the reports, I know what they are and know their purpose.

Q. Now I show you Defendant's Exhibit D dated January 15th and call your attention to the fact that the report shows that Mr. Rogers was then holding that policy, doesn't it?

A. Yes. It states here, under "Remarks" — "State date we may expect to receive payment of premium or any other information of importance",

(Testimony of Arthur F. Lindberg.)

and under the heading of "Remarks", he makes no memorandum.

Q. Never mind that, your counsel can bring that out. The fact is, that this report was made on the 15th of January to your office?

A. No, we sent it out to him from our office on [209] January 15th.

Q. Yes, and you got it back within a few days afterwards, didn't you?

A. It was received on January 23d by our branch office.

Q. Was it in the office at the time you had this conversation with him?

A. No, I had the conversation with him on January 21st, and this date received stamp shows "January 23d".

Q. That is your stamp?

A. He had evidently filled it out and mailed it on the 20th, because that is when it was dated.

Q. According to that, then, this report was mailed the day before you had the conversation?

A. Yes, I would assume so.

Q. The report is dated January 20th, is it not?

A. That is right, and I assume it was mailed on that day.

Q. Did you ever send Mr. Rogers a communication of any kind concerning the rule with respect to the delivery of policies to agents?

A. No, that was discussed with him verbally.

Q. You have no record of such a communication?

(Testimony of Arthur F. Lindberg.)

A. No, I have not. But, at the time he was here—

Q. Now, your counsel can bring out whatever you want. I wanted an answer as to whether you had such a communication with him? [210]

A. I had no communication. I discussed it with him verbally.

Q. And, notwithstanding—when did you discuss it with him verbally?

A. At the time he was here over in the Christmas holidays.

Q. What date did you talk to him?

A. I don't exactly recall the date. It might have been Christmas Day. I was up at the office and he came in to see me when he came up from Willcox.

Q. Will you say you saw him at any time during the time he was here Christmas?

A. Yes, I saw him during the time he was here Christmas.

Q. What day do you say it was?

A. I can't recall as to the exact date. It was sometime during the Christmas holidays.

Q. Was it Christmas Day?

A. It might have been. It was a holiday, I know that. It was either Sunday or Christmas Day, because I was up at the office finishing up some work that I had to do there in the office. There was no one else around the cashier's office or anything.

Q. Yes, and that was after the policy had been delivered to him?

(Testimony of Arthur F. Lindberg.)

A. No, it was prior to the time the policy had been delivered to him, because we mailed the policy to him on the [211] 29th of December. The policy was not in his possession at the time we had that discussion.

Q. Just what was that discussion?

A. Well, he wanted to know what about his policy, how he could arrange to settle for it and things of that kind, and I told him that the company did not take notes on policies on agents own lives.

Q. Was anybody present during that conversation?

A. No, he and I were in the office alone.

Q. And notwithstanding that fact, the policy was sent to him? A. I presume it was.

Q. And you had a conversation almost a month later and you still did not discuss the fact that he had the policy?

A. I don't know. It never came up.

Mr. Dougherty: That is all.

The Witness: I naturally assumed it was in our possession as it should have been.

Redirect Examination

Mr. Ross:

Q. Mr. Lindberg, are the agents of the company given any written instructions regarding whether or or not the company will accept notes?

A. Yes. That is contained in a booklet called "Instructions to agents". [212]

(Testimony of Arthur F. Lindberg.)

Q. I will show you Defendant's Exhibit No. F and ask you if you will point out where——

Mr. Dougherty: We submit the pamphlet he has in his hands speaks for itself.

Mr. Ross: I merely asked him to point out——

Mr. Dougherty: Well, you can point it out to the jury.

The Court: Oh, he can find it. Wasting time.

The Witness: Should I read the——

The Court: Yes, read it.

Mr. Ross: Yes, if you will read it please?

The Witness: On page 6, under section 12 headed "Notes"—"The company will not accept a note in payment of the whole or any part of the first premium on a policy. The company will accept cash only in payment of a first premium. If an agent takes a note, he does so at his own risk and must be personally responsible for same. Agents are instructed not to issue a coupon receipt attached to an application in exchange for a note or for anything except cash."

Q. Was Mr. Rogers given a copy of this set of instructions?

A. Yes, he was at the time he signed his contract papers.

Mr. Dougherty: May I see that when you are through with it?

(The document was handed to Mr. Dougherty.)

(Testimony of Arthur F. Lindberg.)

Mr. Dougherty: On what page, do you remember?

Mr. Ross: On page 6.

The Witness: 6.

Recross-Examination

Mr. Dougherty:

Q. Now, Mr. Lindbergh, this provision reads as follows:

“The company will not accept a note in payment of the whole or any part of the first premium on a policy. The company will accept cash only in payment of the first premium. If an agent takes a note, he does so at his own risk and must be personally responsible for same. Agents are instructed not to issue a coupon receipt attached to an application in exchange for a note or for anything except cash”.

Now, withstanding this provision, you do deliver policies without the pre-payment of the first premium, don't you?

A. Where the agent takes the note payable to himself.

Q. Yes, but notwithstanding the provisions here, you do deliver your policy?

A. The agent delivers the policy in exchange for the note made payable to himself.

Q. What is the difference, Mr. Lindberg, whether you deliver them through the agent or himself?

(Testimony of Arthur F. Lindberg.)

Mr. Jenckes: Well, that is argumentative.

Mr. Dougherty: Yes, that is true, it is argument, but [214] it is arguing with the arguer.

The Court: You can argue that to the jury.

Mr. Dougherty: It is true that the agent takes a note to himself. He does that to protect himself, does he not?

The Witness: Yes, naturally.

Q. Because you look to him for the payment of the premium, don't you? A. Yes.

Q. You extend credit to the agent, that is right, isn't it?

A. Yes, where the applicant is someone other than an agent of the company.

Q. Well, it does not say anything about that in here, does it? A. I don't know.

Q. I will ask you to examine it and see if you find anything (handing document to witness)?

A. I am quite sure there is nothing in here that says anything about that.

Q. No, I felt sure there was not. The fact is, that notwithstanding your written instructions there you constantly waived that and delivered the policies without the payment of premium?

Mr. Jenckes: We object to that on the ground it has been asked and answered two or three times.

The Court: Twenty-three times. [215]

Mr. Dougherty: Now, Mr. Lindberg, this policy that is being sued on here is similar to policies you

(Testimony of Arthur F. Lindberg.)

issued on insurance under the same circumstances continuously, is it not?

The Witness: Yes, except that particular policy had an aviation exclusion clause.

Q. And this policy contains substantially the same provision that we have just been speaking of?

A. How do you mean?

Q. This policy provides that this contract of application—no, this contract is made in consideration of the application therefor and of the payment in advance of the sum of \$40.50, the receipt of which is hereby acknowledged, constituting the first premium and maintaining this policy for the period terminating on the 19th day of June, 1940, and of a like sum in said date and every six calendar months thereafter during the lifetime of the insured?

A. Yes, that phraseology is the same that is contained in all of our policies.

Q. And substantially the same is contained in here, in this pamphlet?

A. I don't think there is anything pertaining to that in the pamphlet.

Q. Well, in both there is a provision that the policy will not be delivered until the payment is pre-paid, the premium is pre-paid? [216]

A. Yes, but they make exception there that the agent can take a note.

Q. And you make the same exception when you deliver the policy, notwithstanding this provision in here, in this policy, that the policy is not to be de-

(Testimony of Arthur F. Lindberg.)

livered until the premium is pre-paid, you do deliver policies under your practice and did so at the time Mr. Rogers was engaged, didn't you?

A. The agents delivered the policies at times on a note for the first premium made payable to themselves.

Q. Will you please examine the marked portion of this letter, Mr. Lindberg (handing document to the witness). It is on the first page, just the marked portion?

A. (Examining document) Yes.

Q. Now, in this letter of January 23d, 1940, written by Mr. Caskey to Mr. Rogers, this language is used: "The policy issued on your life was forwarded to you in error as until settlement of the first premium has been made in cash we are not permitted to forward a policy to an agent on his own life. Therefore, will you please see that the policy is returned to the office at once to be held until you can make settlement of the first premium."

That was written to Mr. Rogers?

A. Yes.

Q. And what you wanted to do is to get it back in your hands until he could pay the premium?

[217]

A. That is correct.

Q. There was nothing said there that it had been sent without pre-payment of cash? You wanted to fortify yourself by getting the policy back in your hands?

(Testimony of Arthur F. Lindberg.)

A. Well, naturally, the office made an error in sending it out in the first place.

Q. That is what you said?

A. We were to get it back.

Q. You said nothing in this letter concerning the waiver, did you? A. What waiver?

Q. This airplane waiver? A. No.

Q. And you said nothing to him about the policy being ineffective, did you?

The Court: The letter speaks for itself, you don't have to say anything it does not say.

Mr. Dougherty: Oh, that is true. That is all.

Redirect Examination

Mr. Ross:

Q. Is that letter to which Mr. Dougherty was referring the original of the letter that was sent to Mr. Rogers?

A. Yes, that is the original copy.

Q. Will you explain how the original happens to be in the possession of the New York Life Insurance Company? [218]

A. That was sent to us among other papers that were taken out of his car by the officer at Fort Huachuca and mailed to us in a large envelope.

Mr. Ross: That is all.

Mr. Dougherty: No questions.

(The witness was excused.)

The Court: Anything further?

Mr. Ross: Nothing further here. They say they rested?

The Court: I don't know whether this is surrebuttal or rebuttal.

Mr. Ross: We rest.

The Court: Does everybody rest? Do you rest?

Mr. Dougherty: Yes.

The Court: All right.

Mr. Ross: At this time, your Honor, we would like to make a motion in the absence of the jury.

The Court: All right, you may retire from the court room.

(Thereupon the jury was excused from the court room.)

Mr. Ross: Your Honor, we request at this time that the jury be instructed to return a verdict for the defendant, and we make a motion to that effect. This motion is predicated on three points. The first is that there has been no evidence that any premium has been paid on this policy in question or that there was any waiver of a premium; the second point is, that there is no evidence that [219] the policy was delivered. In fact, the only evidence is to the effect that it was forwarded to him through inadvertence and mistake, and the third point is that it has been shown by the evidence that there is no authority on the part of Mr. Lindberg, or any other agent in Arizona, to waive the payment in cash or the premium due on this policy, and also

Mr. Rogers was advised of the limitations of the agents' authority.

Now, on the question of the evidence, the only scrap of testimony on which the plaintiff might rely would be Mrs. Rogers' testimony relative to her conversations with Mr. Lindberg, and also her son's testimony. You will remember that they testified that Lindberg told them that there had been an agreement that Rogers should pay the premiums due on this policy out of his commissions. Now, the evidence conclusively shows that there were commissions earned. There is no showing that the payment of the premiums out of the commissions was waived; in fact, there is no showing that the policy ever went into effect.

Now, on the question of delivery, the application provides that—it reads, as follows:

“That the insurance hereby applied for shall not go into force unless and until the policy is delivered to and received by the applicant and the first premium thereon paid in full during his lifetime——”.

Now, the delivery is purely a question of intention and [220] there is no legal delivery when the policy inadvertently is parted with. Here, there was no intention on the part of the company that this policy should ever have an effective delivery and for that reason there is no showing on the part of the plaintiff that the policy ever went into effect or that this provision of the application was complied with.

Now, even if the plaintiff argues that the testimony relative to Lindberg's admissions might be twisted around or interpreted to the effect that there was some sort of a credit arrangement between Lindberg and Mr. Rogers, nevertheless, it has been clearly shown that he had no authority to enter into such an arrangement so as to bind the company. The application states that the premium has to be paid before the policy goes into effect. It also states that certain designated officers of the company have authority to waive those terms in the application. Furthermore, the instructions which were given to every agent states that cash has to be paid in order to comply with the company's requirements regarding the premium payments. There is nothing which would support any argument that Lindberg was authorized by that credit arrangement to bind the company.

Now, we have cases to the effect that an agent is not authorized to deliver a policy on an insured's oral promise to pay, or anything like that so as to waive the usual requirements of which the insured is given notice. We have cases to the effect that the requirement of delivery must be [221] complied with and delivery is purely a question of intention on the part of the parties.

Mr. Connor: If your Honor please, we believe, of course, that there is evidence of the waiver by this general manager, and we have cases, of course, to show that the general manager may, or the general manager of the company may waive the pro-

visions of this policy notwithstanding its strict terms, and we are certain that there is direct evidence in here by admission against interest on the part of Mr. Lindberg and which is corroborated that some sort of an arrangement had been made, and we can show your Honor cases to the effect that waiver may arise and may be shown by the facts and circumstances of a particular transaction, and that waiver oftentimes arises by expression and sometimes more by implication, and the implication in this case contained in the conversations are in the evidence as to conversations between Mr. Lindberg and Mrs. Rogers and overheard by Gale Rogers, to the effect that some arrangement had been made, and if the arrangement had been made, we think it is immaterial whether or not he had earned commissions in the future to pay. The mere fact he had earned commissions is beside the point. He rather indicated to Mr. Clem and to others that he thought this gentleman was a good salesman. There is evidence in the record to show that at least the man started out with a fairly good record for a new man and it can very well be implied and inferred that [222] those men suspected that he was going to be such a caliber of salesman that probably he would earn commissions to pay his premiums in the future.

Of course, the matter of intention is a matter of construction upon their part. There is no evidence here of a mistake with reference to a mistake contemplated by the law that there should be mutuality

in the mistake. They are attempting to profit by their own mistake, and I don't believe that evidence to show a unilateral mistake would be sufficient to take this case away from the jury.

True, there is no direct evidence of payment, which we assert and can show by our cases that it is necessary when there has been no credit arrangement made. Throughout the testimony of both Mr. Caskey and Mr. Lindberg, they had asserted that there are instances where these policies are delivered without strict compliance with the rules of the company. There is no evidence to show any communication had been given to Mr. Rogers, for instance, to the effect that policies were not delivered to an agent on his own life without the acceptance of cash premium in the first instance. Neither is there any indication that there was a fair opportunity for Mr. Rogers to have answered that letter which was sent to him on the 24th, and he being injured in this automobile accident on the 26th. We might well infer that he probably could have answered that letter with the **direct statement that** credit arrangement had been made between [223] himself and the general manager of this company, from whose title one might imply from every process of reasoning that he had the right to waive the payments on these policies, and we have ample authorities to show.

(Further argument.)

Mr. Dougherty: I would like to add a word, if I may. In this matter, your Honor please, briefly

stated, Rogers, Mrs. Rogers says, in his lifetime Rogers applied for and received a policy on his life, and while he had not paid the first premium on it, he had made arrangements whereby he might pay the premium out of his earnings. On the other hand, the defendant says it is true that he applied for the policy and received it and it was delivered to him, "but we should not have delivered it to him, and, furthermore, he did not sign a certain waiver".

We are here concerned by reason of the motion before your Honor on the question of whether there is sufficient evidence to go to the jury with respect to our right to enforce this policy. The evidence shows that notwithstanding company declarations that the policy will not be delivered until the premium is pre-paid, that they customarily and continuously delivered these policies without the pre-payment of the premium. Not only in Mr. Rogers' case but in their regular—— in the regular course of their business. I would not venture to say how many of their policies, but apparently a great majority of their policies [224] are delivered without the pre-payment of the premium, so that we may well say that the provision for the pre-payment of the premium is constantly waived by the company.

Now, in this case we may stand on the proposition that in the ordinary course of their business the company waives that requirement. Furthermore, that we had a special agreement whereby credit was

extended to us. Now, the truth of it is, that had Mr. Rogers lived and everything gone well, that policy would have been paid for and the company would not have been worried about it, nor would they stand on technicalities whether or not he did pay the premium or how he was to pay it.

There can be no doubt in your mind or the minds of the jury that Mr. Clem was logically connected with this transaction, and that he received an order for the payment of his money and that subsequently he had a conversation with Lindberg, and that conversation would indicate that Mr. Lindberg recognized the contract, that the requirement for the prepayment of insurance might be waived because he entered into an agreement with Mr. Clem concerning it, so that in conclusion we have a situation where Mrs. Rogers seeks to enforce this policy because she says it was delivered to him regularly, he received it; it was in his possession when he died, and on its face it says, provides for the acknowledgement of the payment of the premium, whether by cash or otherwise, it doesn't make any difference, [225] and it is wrongfully taken from her possession, that her husband had made arrangements for credit and certainly, the jury is entitled to pass on that question.

The Court: Yes, I think so. Call in the jury.

(Thereupon the jury returned into the court room and took their positions in the jury box.)

The Court: We will suspend until one-thirty, gentlemen. Keep in mind the Court's admonition,

and keep in mind to come back at one-thirty, rather than two.

(Thereupon a recess was taken at 11:45 o'clock A. M.)

1:30 o'clock P. M., April 23d, all parties as heretofore noted by the Clerk's record being present, the trial resumed as follows:

The Court: You may proceed with the argument. Each side may have thirty minutes.

(Thereupon closing arguments were made to the jury by counsel for the respective parties, after which the Court instructed the jury as follows:)

THE COURT'S CHARGE TO THE JURY

The Court: It now becomes the Court's duty, gentlemen, to instruct you as to the law that applies to this case, the issues that are not at all involved.

You will recall the plaintiff seeks to recover \$4,000.00 [226] upon a policy of insurance issued by defendant company upon the life of her deceased husband. It is not disputed that this policy was in the possession of assured at the time of his death. However, defendant claims the first premium had not been paid on the policy, that it was mailed to Mr. Rogers through error and, therefore, is not an enforceable contract. Plaintiff does not contend that the first premium was paid in cash, but claims that payment in cash had been waived, and that it was agreed between Mr. Lindberg and her husband that payment could be made out of the commissions or earnings of deceased. The company, of course, denies such agreement was made.

You are instructed that if you believe from the evidence that prior to and up to and including the date of delivery of the life insurance policy sued on herein—I will say, rather the mailing of the life insurance policy sued on herein, the New York Life Insurance Company voluntarily and knowingly held Arthur F. Lindberg and David F. Caskey out to the world as its agency directors for the State of Arizona, and as authorized to supervise, direct and control the said company's life insurance business within said State of Arizona, and to permit, authorize or direct the delivery of life insurance policies similar to the one herein involved without the pre-payment of the first premium, or any premium thereon, and had so conducted itself in this regard, as to reasonably justify the public generally, and those [227] dealing with it, in believing that the said Arthur F. Lindberg was authorized, permitted or directed to deliver, permit or cause to be delivered similar policies, and that the policy herein involved was received and accepted by the said Zeno A. Rogers, believing that the said Arthur F. Lindberg had authority to so deliver said policy without the pre-payment of premium, then the New York Life Insurance Company, in the absence of some reason or cause deemed sufficient in law, would be bound by the acts of the said Arthur F. Lindberg.

You are instructed that either by contract or by operation of law the said Arthur F. Lindberg, as agency director, the said David F. Caskey, as agency

cashier for the State of Arizona, and/or any other persons employed in said agency office, charged with the duty of handling, controlling, mailing or delivery of insurance policies within the scope of their employment are regarded as agents of the defendant company; and you are further instructed that such persons as agents could bind the defendant company within the limits of the authority with which they, or any of them, apparently were clothed, in respect to the subject matter of his agency, and for the protection of innocent third persons.

The authority of an agent is enlarged by implication when the principal permits the agent to do acts not expressly authorized and if, through inattention or otherwise, the defendant company suffered its agents, or any of them, to [228] act beyond his, or their authority without objection, then the company, in the absence of some reason or cause deemed sufficient in law, is bound to those who were not aware of any want of authority, to the same extent as if the requisite power had been directly conferred.

You are instructed that if you find from the evidence that the policy sued on herein was mailed to, and received by the said Zeno A. Rogers previous to the time of his death, or that said policy was found among the papers of the said Zeno A. Rogers after his death, and that said policy acknowledged the payment of the first premium, then such delivery, possession and acknowledgment constitute *prima facie* evidence of a binding contract of in-

surance, and the burden of proof falls upon the defendant company to establish by evidence some reason regarded by the law as good and sufficient, why the plaintiff should not recover judgment in this action.

You are instructed that the application for life insurance policy signed by Zeno A. Rogers and said life insurance policy issued in connection therewith are to be construed together, and if you find from the evidence that the said Zeno A. Rogers, in his executed application, waived all benefits of his insurance policy in case of an accident in connection with aircraft, then you are instructed that the signature of Zeno A. Rogers to the so-called permanent aviation clause proposed for his further signature, was not [229] essential to constitute an enforceable life insurance contract; and if you find all other necessary facts in favor of the plaintiff, you are instructed that the plaintiff is entitled to recover in this action, notwithstanding any such failure, if such you find, on the part of Zeno A. Rogers to sign said permanent aviation clause previously to the delivery to him of said insurance policy.

You are instructed that if you find from the evidence that at any time previous to the death of Zeno A. Rogers, the defendant, acting in this behalf by its proper authorized officers agreed expressly or by implication that Zeno A. Rogers might pay the first premium due on the policy herein involved, out of his commissions or future earnings, then you

are further instructed that such an agreement could not be rescinded or terminated by the defendant after the death of the said Zeno A. Rogers without the consent of Mrs. Rogers, the beneficiary, named in the policy.

The Court instructs you that an insurance policy may be issued and signed by the defendant company and still be inoperative for want of delivery, for the application signed by Rogers provided that the insurance should not go into effect unless and until the policy was delivered. The question of delivery is always one of intention. Consequently, if you find that the defendant company forwarded the policy to Zeno A. Rogers by mistake and without the intention of parting with possession of it, then there was no [230] delivery of the policy and your verdict must be for defendant.

It is provided in the application which Zeno A. Rogers made for the insurance policy in question that the insurance applied for should not go into effect until the first premium was paid in full during the insured's lifetime. The burden of proof is upon the plaintiff to satisfy you by a preponderance of the evidence that Zeno A. Rogers paid the first premium to defendant, unless you find that credit for said premium was extended to Zeno A. Rogers by Lindberg while acting within the scope of his employment.

The burden is cast upon the plaintiff to establish affirmatively by a preponderance of the evidence the allegations of her complaint. You are instructed

that by "preponderance of evidence" as used in these instructions, we mean that degree or quantum of evidence which causes the mind of a reasonably prudent person to lean to one side of a proposition as against evidence opposed to it. It is evidence which is more convincing, more weighty than evidence opposed thereto.

You are made by law the sole judges of the credibility of the witnesses and the weight to be given their testimony. In determining the credibility of the witnesses in this case, you have the right to take into consideration the manner and appearance of the witnesses in giving his or her testimony, his or her means of knowledge of the facts in which he [231] or she testified; any interest he or she may have shown, and the probability or improbability of the truth of his or her statements when considered in connection with all other evidence in the case.

If you believe that any witness has willfully testified falsely to any material fact, then you have the right to wholly disregard the testimony of such witness except insofar as the same may be corroborated by other credible evidence in the case.

When you retire to your jury room you will select one of your number to act as foreman and proceed with your deliberations. If you agree upon a verdict, you should have it signed by your foreman and return it to open court. Any verdict agreed upon must be unanimous.

Two forms of verdict have been prepared for your guidance. Omitting the title of the court and

cause, they read: "We, the jury, duly empaneled and sworn in the above entitled action, upon our oaths, do find for the plaintiff." "We, the jury, duly empaneled and sworn in the above entitled action, upon our oaths, do find for the defendant", and have it signed by your foreman on whichever verdict you agree upon.

Swear the bailiff to take charge of the jury.

(The Bailiff was sworn and the jury retired from the court room in his custody.)

The Court: Are there any exceptions to the instructions [232] as given?

Mr. Ross: The defendant objects to plaintiff's instruction number 1 on the ground that the evidence shows that Zeno A. Rogers had actual knowledge of the limitations of Lindberg's authority and, consequently, the question of the scope of his apparent authority has no application here. Further, there is no evidence that Lindberg or Caskey were authorized to deliver an insurance policy similar to the one here involved without a pre-payment of the first premium.

Defendant further objects to this instruction on the ground it is an incorrect statement of the law and its application to the facts of this case.

Defendant objects to plaintiff's instruction number 2 on the same grounds as set forth in the objections to the previous instruction, and on the further ground that it is vague and unrelated to the facts in the case.

Defendant objects to plaintiff's requested instruction number 3 on the ground that the burden of proving delivery of the policy rests with the plaintiff and is not changed by the fact that plaintiff was initially aided by its presumption of law arising from the insured's possession of the policy.

Defendant further objects on the ground that a presumption such as this is not to be construed by the jury as evidence. The portion of the instruction relating to "some reason regarded by the law as good and sufficient" is vague, [233] and the last phrase of the instruction is an incorrect statement of the law.

Defendant objects to plaintiff's requested instruction number 4, on the ground that it is an incorrect statement of the law as applied to the facts of this case. The defendant company had the right to modify its insurance policies in whichever way it felt good business practice required.

Defendant objects to plaintiff's requested instruction number 6 on the ground that it has no bearing to any of the issues in this case, and on the further ground that it is an incorrect statement of the law as applied to the facts of said case.

Mr. Dougherty: Are you through, Mr. Ross?

Mr. Ross: Yes.

Mr. Dougherty: The plaintiff objects to both instructions requested by the defendant, for the reason that the instructions assume a state of facts not established, that they are not applicable to the facts as developed in the trial of this case and are

not a statement of the corrected rule of law applicable to the facts developed from the trial of this case.

Mr. Ross: Note an exception.

Mr. Dougherty: Note an exception.

(Thereupon the trial was ended.) [234]

I, hereby certify, that the proceedings had and evidence given upon the trial of this cause is contained fully and accurately in the shorthand notes taken by me of said trial, and that the foregoing 159 typewritten pages contain a full, true and accurate transcript of the same.

LOUIS L. BILLAR

Official Shorthand Reporter.

[Endorsed]: Filed July 17, 1941. [235]

[Endorsed]: No. 9892. United States Circuit Court of Appeals for the Ninth Circuit. New York Life Insurance Company, a Corporation, Appellant, vs. Lois Rogers, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Arizona.

Filed August 11, 1941.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 9892

NEW YORK LIFE INSURANCE COMPANY,
a corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

STATEMENT OF POINTS ON WHICH AP-
PELLANT INTENDS TO RELY AND AP-
PELLANT'S DESIGNATION OF PARTS
OF RECORD

Comes now the appellant, New York Life Insurance Company, by its attorneys, Ellinwood & Ross, Jos. S. Jenckes, Jr., and Everett M. Ross, and pursuant to Rule 19 of the United States Circuit Court of Appeals for the Ninth Circuit states that the following is a concise statement of the points on which it intends to rely on the appeal of the above entitled action:

I

The trial Court erred in denying defendant's motion at the close of all the evidence to instruct the jury to return a verdict for defendant. Said motion should have been granted for the following reasons: (a) The evidence disclosed that there was no legal delivery of the life insurance policy

involved in this action and that no payment of the first premium was ever made thereon, which said acts were by the terms of the policy conditions precedent to its becoming effective; (b) The evidence disclosed that the application for the insurance policy on which this action was based was rejected by defendant's making a counter-offer to applicant which said counter-offer was not accepted by applicant.

II.

The trial Court erred in certain particulars of its general charge to the jury, namely, in giving plaintiff's instructions No. 1, 2, 3, 4 and 6. The defendant specifically excepted to said instructions at the time and the grounds for said objections are set forth at pages 158 and 159 of the Reporter's transcript of record on file herein.

III.

The verdict and judgment were not justified by the evidence and were contrary to law in that there was no evidence that a contract of insurance was ever entered into between defendant and Zeno A. Rogers, the applicant.

DESIGNATION OF PARTS OF RECORD

Appellant thinks that the parts of the record which it designated in the Designation of the Contents of Record on Appeal which it filed in the District Court of the United States for the District of Arizona are necessary for a consideration of the

aforesaid points and appellant therefore adopts said designation.

Dated this 15th day of August, 1941.

ELLINWOOD & ROSS

JOS. S. JENCKE, JR.

EVERETT M. ROSS

Attorneys for Appellant

Received copy this 14th day of August, 1941.

DOUGHERTY and CHANDLER

By ALLIE MAE TALLEY

Attorneys for Appellee.

[Endorsed]: Filed Aug. 15, 1941. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

APPELLEE'S DESIGNATION OF
ADDITIONAL PORTIONS OF RECORD

Comes now the appellee, Lois Rogers, by her attorneys, John Francis Connor, and Dougherty and Chandler, and M. J. Dougherty, and pursuant to Rule 19 of the United States Circuit Court of Appeals for the Ninth Circuit, files a designation of additional portions of the record which she thinks material.

DESIGNATION OF PARTS OF RECORD

Appellee believes that the additional parts of the record which she designated in the appellee's designation of additional portions of record on appeal

which she filed in the District Court of the United States for the District of Arizona are necessary for a consideration of the matter and appellee, therefore, adopts said designation.

Dated this 21st day of August, A. D. 1941.

JOHN FRANCIS CONNOR
DOUGHERTY and CHANDLER
By M. J. DOUGHERTY

Attorneys for Appellee.

Service of the within appellee's designation of additional portions of record is hereby acknowledged this 21st day of August, A. D. 1941.

ELLINWOOD and ROSS
By JOS. S. JENCKES JR.

.....
Attorneys for Appellant.

[Endorsed]: Filed Aug. 23, 1941. Paul P.
O'Brien, Clerk.

IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

APPELLANT'S OPENING BRIEF

ELLINWOOD & ROSS,

JOS. S. JENCKES, JR.,

EVERETT M. ROSS,

807 Title & Trust Building,
Phoenix, Arizona

Attorneys for Appellant.

FILED

OCT - 3 1941

PAUL P. O'BRIEN

TOPICAL INDEX

Statement of Pleadings and Facts Disclosing Basis of Jurisdiction	1
Statement of the Case	3
Summary	17
Specifications of Error	11
Argument	19
Issue I—Rogers' failure to accept appellant's of- fer of policy in manner indicated by appel- lant prevented consummation of contract of insurance	19
Issue II—Legal delivery of policy to Rogers was essential to consummation of insurance con- tract	24
Issue III—Rogers' failure to pay initial pre- mium prevented insurance from going into effect	30
Issue IV—Scope of Lindberg's apparent author- ity was not proper subject for jury's consid- eration when evidence disclosed Rogers' knowledge of limitations on Lindberg's ac- tual authority	41
Issue V—Rogers' possession of policy which evi- dence showed was forwarded to him by mistake did not place on appellant burden of proving why beneficiary should not recover judgment	43
Issue VI—Appellant had right to designate man- ner in which its counter-offer should be ac- cepted by Rogers	44
Conclusion	45

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Cases

Aetna Life Ins. Co. v. Johnson, (C. C. A. 8th, 1926) 13 Fed. (2d) 824	33
Blackwell v. Roseberry, (La. 1934), 154 So. 641.....	20
Bradley v. New York Life Ins. Co., (C. C. A. 8th, 1921) 275 Fed. 657	36
Braman v. Mutual Life Ins. Co., (C. C. A. 8th, 1934), 73 Fed. (2d) 391.....	39
Curtis v. Prudential Ins. Co., (C. C. A. 4th, 1932), 55 Fed. (2d) 97.....	24
Drake v. Missouri State Life Ins. Co., (C. C. A. 8th, 1927), 21 Fed. (2d) 39.....	24
Etenburn v. Metropolitan Life Ins. Co., 118 Okla., 55, 246 Pac. 383	39
Hruska v. Prudential Ins. Co., 203 Ia. 1165, 211 N. W. 858	25
Jackson v. New York Life Ins. Co., (C. C. A. 9th) 7 Fed. (2d) 31	29
Kinney v. Northern Life Ins. Co., 200 Wash. 190, 93 Pac. (2d) 360	30
Long v. New York Life Ins. Co., 106 Wash. 458, 180 Pac. 479	24, 29
McDonald v. Mutual Life Ins. Co. of N. Y., (C. C. A. 6th, 1939) 108 Fed. (2d) 32.....	22
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Morford v. California Western States Life Ins. Co., (Ore. 1941), 113 Pac. (2d) 629	19

New York Life Ins. Co. v. Horton (C. C. A. 5th, 1925) 9 Fed. (2d) 320.....	31
New York Life Ins. Co. v. Fletcher, 117 U. S. 519, 29 L. Ed. 934	32
New York Life Ins. Co. v. McCreary, (C. C. A. 8th, 1932) 60 Fed. (2d) 355.....	37
Northern Assurance Co. v. Grand View Bldg. Ass'n., 183 U. S. 308, 46 L. Ed. 213	33
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Urseth v. Sun Life Assurance Co. of Canada, (C. C. A. 8th, 1941) 119 Fed. (2d) 529	27
Wells v. Prudential Ins. Co., 239 Mich. 92, 214 N. W. 308	42

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American Jurisprudence, Vol. 29, at page 164.....	24, 26
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Cooley's Briefs on Insurance, 2nd Ed., Vol. 1, p.p. 630	25
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Corpus Juris, Vol. 32, at page 1126.....	26
Ruling Case Law, Vol. 14, page 895	19
53 A. L. R., 492	29
123 A. L. R., 907	29

Statutes

28 U. S. C. A., Sec. 230.....	3
28 U. S. C. A., Sec. 41.....	2
28 U. S. C. A., Sec. 71.....	2
28 U. S. C. A., Sec. 225.....	3

IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

APPELLANT'S OPENING BRIEF

**Statement of Pleadings and Facts Disclosing
Basis for Jurisdiction**

(References are to pages in Transcript
of Record)

Lois Rogers, appellee herein, instituted the above action July 5, 1940, in the Superior Court of the State of Arizona, in and for Maricopa County, for the purpose of recovering from New York Life Insurance Company, appellant herein, the sum of \$4,000.00 on an insurance contract alleged to have been entered into between her husband, Zeno A. Rogers, and appellant. At the time

of bringing the action appellee (plaintiff below) was a resident of the State of Arizona, and appellant (defendant below) was a foreign corporation created under the laws of the State of New York and a non-resident of the State of Arizona. On the 20th day of July, 1940, appellant in accordance with the provisions of 28 U. S. C. A., Sec. 71, duly removed said action to the United States District Court for the District of Arizona. Under 28 U. S. C. A., Sec. 41, said District Court was given original jurisdiction over said action by reason of the fact that the matter in controversy exceeded, exclusive of interest and costs, the sum of \$3,000.00, and the action was between citizens of different states. The pleadings necessary to show the existence of the jurisdiction of the District Court are the Complaint (2), the Petition for Removal (7), Notice of Filing Petition for Removal (13), Bond for Removal (15), Order for Removal (17) and Answer to Amended Complaint (22).

At the close of all the evidence introduced at the trial of the cause appellant moved the Court for a directed verdict in its favor. The Court denied this motion (34) and a verdict was returned for appellee. The District Court thereupon entered judgment in accordance with the verdict (37). The appellant made a timely motion to Set Aside the Verdict and Judgment and enter Judgment in accordance with Appellant's Motion for an Instructed Verdict and a Motion for a New Trial (39). The Court on June 28, 1941, denied these motions (41).

Notice of Appeal (42) was filed by appellant. Appellant thereafter filed a Stipulation Waiving Bond on Appeal (43), a Statement of Points upon which Appellant Intends to Rely (44), and Appellant's Designation

of Contents of Record on Appeal (46). The record on appeal was filed in this Court and the cause was docketed herein on the 11th day of August, 1941. By virtue of the foregoing proceedings taken within the time provided by 28 U. S. C. A., Sec. 230, and in accordance with the Rules of Civil Procedure of the District Courts of the United States, the above case is now before this court which under 28 U. S. C. A., Sec. 225, as amended, paragraph A, is given appellate jurisdiction to review final decisions of the District Courts.

STATEMENT OF THE CASE

Substance of the Amended Complaint (18)

1. Appellee alleged that on December 7, 1939, Zeno A. Rogers applied to appellant for a life insurance policy and that thereafter appellant issued and delivered to him a policy insuring his life in the sum of \$2,000, with double indemnity features; that appellee was named beneficiary thereunder.

2. Alleged that said Zeno A. Rogers paid the initial premium on such policy and duly performed all the conditions thereof.

3. Alleged that Zeno A. Rogers died on January 28, 1940, as the result of an accident.

4. Alleged that though appellee demanded payment of the death benefits under said policy, appellant refused to pay said benefits.

Substance of Answer to Amended Complaint

The pertinent allegations in appellant's answer to the amended complaint (22) were as follows:

1. Appellant alleged that it did not issue the type of policy applied for by Zeno A. Rogers; that it issued a policy which differed from that applied for in that appellant indorsed thereon a rider clause modifying its liability in the event of the death of the insured while riding in or operating an aircraft.

2. Alleged that appellant mailed said policy to its Arizona Branch Office on December 19, 1939, with instructions that it not be delivered to Rogers until he paid the first premium and signed an agreement accepting the policy as modified by the aviation indorsement.

3. Alleged that through inadvertence and mistake and contrary to said instructions appellant's Arizona Branch Office forwarded the policy to Rogers without collecting the initial premium and without obtaining his signature to the agreement accepting the policy as modified; that appellant notified Rogers that the policy had been forwarded to him in error and requested him to return it.

4. Alleged that Rogers did not return the policy, did not pay appellant the first premium thereon and did not execute the agreement accepting the policy as modified.

Important Evidence

1. *Evidence pertaining to Rogers' employment by appellant and his application for a policy of insurance.*

On October 28, 1939, Rogers filed with appellant an application for a contract to write insurance as agent for appellant, and he thereupon commenced soliciting

insurance as one of appellant's agents in a regularly assigned territory (59). Though he was successful in obtaining many applications for policies, he earned no commissions from appellant, for he never remitted to appellant any of the premiums which he collected (154). At the time of his death he was indebted to appellant for premiums which he had collected but which he had failed to remit to appellant.

On December 7, 1939, Rogers applied to appellant for an insurance policy on the ordinary life plan, payable to appellee in the face amount of \$2,000.00 upon receipt of due proof of the death of applicant and double the face of the policy upon due proof that death resulted from accident as defined under the provisions of the policy relating to double indemnity (P's Ex. 3-92).

2. Evidence that appellant issued a policy differing from that applied for and that Rogers failed to accept the same.

Under the type of policy Rogers applied for, the beneficiary was entitled to receive the face amount of the policy in the event the insured's death resulted from operating or riding in an unlicensed aircraft (92). Because Rogers' application disclosed that he had engaged in aeronautics, appellant issued a policy with a Permanent Aviation Clause which had the effect of lessening its burden if Rogers' death occurred while operating or riding in an unlicensed aircraft (90). Under this clause the beneficiary would receive only the reserve of the policy at the date of death instead of the face amount thereof.

When appellant forwarded the policy to its Arizona Branch Office it sent with the policy an agreement which

the applicant was to sign for the purpose of indicating his acceptance of the policy as modified (109). The applicant's signature was typed in on a copy of this agreement which was attached to and made a part of the policy. The Arizona Branch Office was instructed not to deliver the policy to applicant until the original agreement was signed, witnessed and returned to the office (D's Ex. C-1) (114).

3. Evidence that the policy was forwarded to Rogers through inadvertence and mistake.

Mr. Caskey, Cashier of appellant's Arizona Branch Office, testified that when an agent was handling a policy for someone other than himself, the policy was sent to him by the Arizona Branch Office and he was responsible for the collection of the first premium (123). He added that "when a policy comes out on the agent's own life, there is no one to represent him, he is representing himself with the result that we are supposed to hold the policy and tell him that upon the payment of the premium and his signature on any amendments to his original application." He further testified that this policy was forwarded to Rogers through error in office routine, resulting from the fact that the typist who billed the policies out to the agents in groups of 75 or 100 did not recognize the name of Rogers (124).

It was the practice of each of appellant's agents to submit to Caskey on the 15th day of each month, a report of the policies which had been forwarded to such agent (125). When Caskey received Rogers' report on January 20, 1940, he noted that Rogers' own policy was included in the report and he therefore wrote Rogers a letter on January 23, 1940, (129-D's Ex. E) in which he stated:

"The policy issued on your life was forwarded to you in error, as until settlement of the first premium has been made in cash we are not permitted to forward a policy to an agent on his own life. Therefore, will you please see that the policy is returned to the office at once to be held until you can make settlement of the first premium."

The above letter and the policy were both found in Rogers' possession at the time of his death (215). There is no evidence that Rogers signed the agreement which appellant had asked him to sign in order to indicate his acceptance of the policy as modified by the aviation indorsement.

4. *Evidence that the payment of initial premium was a condition precedent to the insurance becoming effective and that such premium was not paid.*

The application which Rogers made for a policy provided (93-94):

"It is mutually agreed as follows: (1) that the insurance hereby applied for shall not go into force unless and until the policy is delivered to and received by the applicant and the first premium thereon paid in full during his lifetime. * * *

The application also provided:

"That if the applicant pays the agent in cash the full amount of the first premium * * * and so declares in the application and receives from the agent a receipt therefor on the receipt form which is attached hereto", and was at that time an insurable risk as shown by the medical examination,

“then said insurance shall take effect and be in force under and subject to the provisions of the policy for which application is made, whether the policy be delivered to and received by the applicant or not.”

Mr. Caskey, in examining appellant's books of account which were introduced into evidence testified that no premium was ever paid on Rogers' policy (131). The application does not indicate that a premium was paid nor was there any evidence that Rogers had received a receipt for the payment of such premium.

5. *Evidence pertaining to waiver of requirement that the first premium be paid in cash.*

The only evidence in the record relative to a waiver of the provision in the policy that the insurance should not become effective until the first premium was paid in full was the testimony of appellee, the beneficiary under the policy. In relating a conversation which she had after Rogers' death with Mr. Lindberg, the director of appellant's Arizona Branch Office, she stated (185):

A. Well, when I said he (Lindberg) had no right to take that (the policy) and he said he did have a right because it was company property, I said, 'Well, isn't it true that you had an agreement of a credit arrangement between yourself and my husband to pay for this premium out of his accumulated earnings.' he said 'Yes, that is the way it was supposed to have been, but unfortunately he died before he was able to pay anything on it.' And I said, 'I still want the policy. I consider it my property'. He said 'Well, I can't give it to you.'"

This testimony was admitted over appellant's objection that Lindberg was without authority to bind appellant by extending credit for the payment of the first premium.

6. *Evidence that Rogers was notified by appellant that Lindberg had no authority to waive the requirement that the first premium be paid in cash.*

After stating that the insurance applied for should not go into force until the first premium was paid in full, the application provided (94-95):

"(3) That only the President, a Vice-President, a Secretary or the Treasurer of the company can make, modify or discharge contracts or waive any of the company's rights or requirements."

There was no evidence that the requirement that the first premium be paid in full was waived by any of appellant's officers designated in the application as having authority to make such waiver.

In the Book of Instructions (Def's. Ex. F. 134) given to Rogers (210) at the time he was employed as an agent of appellant it was provided:

"2. Unauthorized acts. An agent is not authorized: * * * (b) to make, modify or discharge contracts; (c) to extend the time for paying any premium; * * * (g) to collect or receive any monies for or on behalf of, or due or to become due to, the company except on applications obtained by or through him, and then only in exchange for the coupon receipts attached to the application corresponding in date and number with the application,

and in an amount not exceeding the first premium on the insurance applied for. 20. A policy must not be delivered — (a) if any change whatever has occurred in the health or occupation of the applicant, or if he has consulted or been treated by a physician since the date of his medical examination. In such case the agent must at once return the policy to his branch office with full particulars and await further instructions. The only exception to this rule is where the full amount of the first premium has been paid in cash at the time the application was made and the applicant has signed the declaration at the foot of the application to that effect and received the receipt provided, and the policy has been issued for the amount and on the plan applied for without advance in age or premium. (b) Until the applicant signs and delivers all the papers and performs every act required of him by the company. (c) Until the first premium thereon is in the hands of the agent.

“12. Notes. *The company will not accept a note in payment of the whole or any part of the first premium on a policy. The company will accept cash only in payment of a first premium. If an agent takes a note, he does so at his own risk and must be personally responsible for the same.* Agents are instructed not to issue a coupon receipt attached to an application in exchange for a note or for anything except cash.” (Italics supplied)

Mr. Caskey and Mr. Lindberg both testified that the appellant never sold insurance on credit (159, 202). They stated that though an agent was permitted to accept from an applicant a note for the first premium, payable to the

agent personally, that was a private transaction between the agent and the applicant, and the agent was responsible for the remission of the premium in cash, regardless of whether or not the note was paid. The evidence disclosed that the appellant never took notes payable to itself or did any other type of credit business (159).

SPECIFICATIONS OF ERROR

I.

The Court erred in denying appellant's motion for an instructed verdict at the close of the entire case, for the following reasons:

1. The evidence disclosed that the application for the insurance policy on which this action was based was rejected by appellant's making a counter-offer which said counter-offer was not accepted by applicant.
2. The evidence disclosed that there was no legal delivery of the insurance policy involved in this action and that no initial premium was ever paid thereon, which said acts were by the terms of the policy conditions precedent to its taking effect.

II.

The Court erred in giving appellee's requested instruction Number 1, which is in totidem verbis as follows:

"You are instructed, that if you believe from the evidence that prior to and up to and including the date of delivery of the life insurance policy sued on herein, the New York Life Insurance Company vol-

untarily and knowingly held Arthur F. Lindberg David F. Caskey out to the world as its Agency Director for the State of Arizona, and as authorized to supervise, direct and control the said company's life insurance business within said State of Arizona, and to permit, authorize or direct the delivery of life insurance policies similar to the one herein involved without the pre-payment of the first premium, or any premium thereon, and had so conducted itself in this regard, as to reasonably justify the public generally, and those dealing with it, in believing that the said Arthur F. Lindberg was authorized, permitted or directed to deliver, permit or cause to be delivered similar policies, and that the policy herein involved was received and accepted by the said Zeno A. Rogers, believing that the said Arthur F. Lindberg had authority to so deliver said policy without the pre-payment of premium, then the New York Life Insurance Company, in the absence of some reason or cause deemed sufficient in law, would be bound by the acts of the said Arthur F. Lindberg."

It was error to grant said instruction for the following reasons, which were urged by appellant at the trial (229) :

1. As the evidence disclosed that Zeno A. Rogers had actual notice of the limitations which appellant placed upon the authority of its agent, Arthur Lindberg, it was improper to charge the jury that appellant was bound by Lindberg's acts if such acts were within the scope of authority he appeared to have to the public generally.

2. There was no evidence that Lindburg or Caskey was authorized to deliver the policy in question without first receiving payment of the initial premium.

III.

The Court erred in giving appellee's requested instruction No. 2, which is in totidem verbis, as follows:

"You are instructed that either by contract or by operation of law, the said Arthur F. Lindberg, as Agency Director, the said Arthur F. Caskey, as Agency Cashier for the State of Arizona; and/or any other persons employed in said Agency office, charged with the duty of handling, controlling, mailing or delivery of insurance policies within the scope of their employment, are regarded as agents of the defendant company; and you are further instructed that such persons as agents could bind the defendant company within the limits of the authority with which they, or any of them, apparently were clothed, in respect to the subject matter of his agency, and for the protection of innocent third persons.

"The authority of an agent is enlarged by implication when the principal permits the agent to do acts not expressly authorized, and if, through inattention or otherwise, the defendant company suffered its agents, or any of them, to act beyond his, or their, authority without objection, then the company, in the absence of some reason or cause deemed sufficient in law, is bound to those who were not aware of any want of authority, to the same extent

as if the requisite power had been directly conferred."

It was error to give said instruction for the following reasons which were urged by appellant at the trial (229):

1. As the evidence showed that Rogers had actual notice of the limitations on the authority of appellant's agents with whom he dealt, the jury should not have been permitted to consider any question of apparent authority.
2. Said instruction is hopelessly vague in that it fails to define the phrase "some reason or cause deemed sufficient in law."

IV.

The Court erred in giving appellee's requested instruction No. 3, which is in totidem verbis, as follows:

"You are instructed, that if you find from the evidence that the policy sued on herein was mailed to, and received by the said Zeno A. Rogers previous to the time of his death, or that said policy was found among the papers of the said Zeno A. Rogers after his death, and that said policy acknowledged the payment of the first premium, then such delivery, possession and acknowledgment constitute prima facie evidence of a binding contract of insurance, and the burden of proof falls upon the defendant company to establish, by evidence, some reason regarded by the law as good and sufficient, why the plaintiff should not recover judgment in this action."

It was error to give said instruction for the following reasons which were urged by appellant at the trial (230):

1. Though Rogers' possession of the policy gave rise to a presumption of delivery and placed on appellant the burden of going forward with the evidence, this presumption was dissipated by evidence explaining such possession, and plaintiff had the burden of proving that the policy was legally delivered.
2. The Court, in effect, charged the jury that such a presumption could be considered as evidence.
3. It was incorrect to charge the jury that "the burden of proof falls upon the defendant to establish some reason regarded by law as good and sufficient why plaintiff should not recover judgment."

V.

The Court erred in giving appellee's requested instruction Number 4 which is in totidem verbis as follows:

"You are instructed, that the application for life insurance policy signed by Zeno A. Rogers and said life insurance policy issued in connection therewith are to be construed together, and if you find from the evidence that the said Zeno A. Rogers, in his executed application, waived all benefits of his insurance policy in case of an accident in connection with aircraft, then you are instructed that the signature of Zeno A. Rogers to the so-called permanent aviation clause proposed for his further

signature, was not essential to constitute an enforceable life insurance contract; and if you find all other necessary facts in favor of the plaintiff, you are instructed that the plaintiff is entitled to recover in this action, notwithstanding any such failure, if such you find, on the part of Zeno A. Rogers to sign said permanent aviation clause previously to the delivery to him of said insurance policy."

It was error to give said instruction for the following reason which was urged by appellant at the trial (230):

1. It was an incorrect statement of the law to charge the jury that a contract could be consummated even though Rogers did not accept appellant's offer in the manner required by appellant.

VI.

The Court erred in rendering judgment for appellee for the reason and upon the grounds as follows:

1. The verdict is contrary to and not justified by the evidence for the reasons specified in Specification No. I.
2. The judgment is contrary to law for the reasons specified in Specification No. I.

VII.

The Court erred in denying appellant's Motion to Set Aside the Judgment and to Enter Judgment in Accordance with Defendant's Motion for an Instructed Verdict

for the reasons and upon the grounds specified in Specifications Nos. I, II, III, IV, V, and VI.

VIII.

The Court erred in denying appellant's Motion for a New Trial for the reasons and upon the grounds specified in Specifications Nos. I, II, III, IV, V, and VI.

SUMMARY

For the purpose of simplifying the argument the above errors may be divided into six fundamental propositions which become the main issues in the case. These issues will be developed in the following manner:

ISSUE I.

Rogers' Failure to Accept Appellant's Offer of Policy in Manner Indicated by Appellant Prevented Consummation of Contract of Insurance. (*Errors I, VI, VII and VIII*)

(a) Issuance by appellant of policy differing from that applied for constituted counter-offer and rejection of Rogers' application.

(b) Acceptance of counter-offer must be made in manner indicated therein.

(c) No contract is created where counter-offer not accepted.

ISSUE II

Legal Delivery of Policy to Rogers Was Essential to Consummation of Insurance Contract. (*Errors I, VI, VII, and VIII*)

(a) Delivery of the policy was by terms thereof condition precedent to contract.

(b) Appellant's forwarding policy to Rogers through inadvertence and mistake did not constitute legal delivery of policy.

(c) If policy were delivered to Rogers it was delivered to him in his capacity as appellant's agent and not in his individual capacity.

(d) There can be no constructive delivery of a policy when further acts are required of applicant.

ISSUE III.

Rogers' Failure to Pay Initial Premium Prevented Insurance from Going into Effect. (*Errors I, VI, VII, and VIII*)

(a) Rogers was notified that Lindberg was unauthorized to extend credit for payment of initial premium.

(b) Appellant was not bound by Lindberg's attempted waiver of requirement that such premium be paid in full.

ISSUE IV.

Scope of Lindberg's Apparent Authority Was Not Proper Subject for Jury's Consideration When Evidence Disclosed Rogers' Knowledge of Limitations on Lindberg's Actual Authority. (*Errors II and III*)

ISSUE V.

Rogers' Possession of Policy Which Evidence Showed Was Forwarded to Him by Mistake Did

Not Place on Appellant Burden of Proving Why Beneficiary Should Not Recover Judgment. (*Error IV*)

ISSUE VI.

Appellant Had Right to Designate Manner in Which Its Counter-offer Should Be Accepted by Rogers. (*Error V*)

ARGUMENT

Issue I.

Rogers' Failure to Accept Appellant's Offer of Policy in Manner Indicated by Appellant Prevented Consummation of Contract of Insurance..

(a) *Issuance by appellant of policy differing from that applied for constituted counter-offer and rejection of Rogers' application.*

The courts have consistently applied to insurance contracts the fundamental rule of contract law that an acceptance of an offer is of no legal effect unless it is made unconditionally. It is stated in 14 R. C. L., at page 895:

“To be effective the acceptance of an application must be in the very terms offered. Where it is on different terms the contract is not complete until the applicant has signified his acceptance to the new terms.”

In the case of *Morford vs. California Western States Life Insurance Company*, (Ore. 1941) 113 Pac. (2d) 629, the policy issued by the defendant company differed from the policy which had been applied for in that the

policy contained no waiver of premium in case of total disability. The court, in rejecting plaintiff's contention that the policy became effective when it was mailed by the company to its agent, stated, at page 633:

"Until the applicant had notice or knowledge as to the character of the change the company proposed to make and had agreed in writing thereto, the contract of insurance was not complete. In other words, the policy issued was a counter offer, which required acceptance by the applicant in order to be effective as a contract. *Cranston vs. California Insurance Company*, 94 Or. 369, 185 Pac. 292."

The Court later states at page 635:

"And as a general rule, if the insurer replies to the application by proposing different terms, or by sending a policy differing in essential terms from that applied for, no contract is made until the counter proposition or policy has been accepted by the applicant, even though the insurer retains the premium pending action by the insured. In such a case there is no contract, as the minds of the parties never met upon the terms. (Citations)."

The fact that there is only a slight variance between the policy which is issued and the policy which was applied for will not prevent the application of the rule that an offer must be accepted unconditionally.

In the case of *Blackwell vs. Roseberry*, (La. 1934) 154 So. 641, the applicant applied for a policy with an annual premium. The company, however, issued a policy with a semi-annual premium. In holding that there was no con-

tract of insurance until the policy was accepted by the applicant the court stated:

“The general rule is that, when a policy varies in any way from the terms proposed in the preliminary negotiations, it becomes in its turn a mere counter proposition ‘and to constitute a binding contract must be accepted by the applicant.’ Cooley’s Briefs on Insurance, Second Edition, Vol. 1, page 673; Mutual Life Insurance Co. vs. Young, 23 L. Ed. 152; Cooley’s Briefs on Insurance, Second Edition, Vol. 1, page 674.”

In the case before the court Rogers applied for a policy which would pay his beneficiary the face amount of the policy in the event Rogers’ death occurred while riding in or operating an unlicensed aircraft. Appellant, however, issued a policy which would pay the beneficiary only the reserve amount of the policy in the event Rogers’ death occurred under such circumstances.

How can it be argued that this was an unconditional acceptance of the application? This plainly was a rejection of the application. In legal effect appellant’s issuance of a policy incorporating different terms constituted a counter offer.

(b) *Acceptance of counter-offer must be made in manner indicated therein.*

Appellant instructed its Arizona Branch Office not to deliver the policy to Rogers until he had signed an agreement indicating that he accepted the policy as modified by the aviation endorsement (114). As the policy contained terms to which Rogers had not assented, he had

the right to reject it. The fact that Rogers accepted the policy from the mails would not establish in appellant's records whether or not he had decided to accept or reject it. No one will quarrel with the wisdom of appellant's adding to its counter offer a condition that acceptance should be indicated by executing and returning to appellant the enclosed agreement. This Rogers failed to do.

(c) *No contract is created where counter-offer not accepted.*

In the case of *McDonald v. Mutual Life Insurance Company of New York*, (C.C.A. 6th, 1939) 108 Fed. (2d) 32, the applicant named his children as the beneficiaries in the policy to be issued but failed to insert in the application a provision covering the payment of the proceeds in the event his children predeceased him. The defendant company attached to the policy it issued a rider providing for the payment of monthly instalments of \$50 each to the children during their lives and on their death the payment of a lump sum to the executor of the last survivor. The policy was mailed to the applicant with instructions that he sign and return an enclosed statement indicating his approval of the endorsement pertaining to Mode of Settlement. Though the applicant made provision for payment of the premium and obtained possession of the policy, the court held that the consummation of an insurance contract was prevented by applicant's failure to sign the agreement accepting the policy as modified. The court stated:

“As the application was for a policy principally for the benefit of the children, the ‘mode of settlement’ was of major importance. It was an offer of

a new contract, and could be accepted only by an unequivocal indication that the applicant had been aware of and was satisfied with the changes made in the instrument. This was to be shown by the applicant's signature to the form of acceptance of the mode of settlement and to the inspection receipt, and their return to the company. While the inspection receipt contained certain provisions with reference to payment of premium, plainly inserted because of the fact that the proposed policy, as was customary, acknowledged receipt of the first premium, it was not ambiguous, and its principal condition is that the policy is received for inspection only. These conditions were communicated to the applicant not only by being enclosed with the letter, but by the instruction of the agent, 'if you will approve of the rider, will you please sign the two enclosed forms and return to me.' The mailing of the check for the premium was not compliance with these conditions, nor did it constitute acceptance of the offer. At the time of the applicant's death, the policy, therefore, was not in effect."

In a life insurance contract, as in the case of all contracts, it is essential that there be a meeting of minds of the contracting parties. Rogers had but one method of indicating that he would enter into a contract and that was to execute and return to appellant the agreement accepting the policy as modified. As he failed to do this the minds of the parties never met on the terms of the contract. Several very pertinent decisions holding that there is no meeting of minds and consequently no contract when the applicant fails to accept or reject a policy differing from that which was applied for are: *Long vs.*

New York Life Ins. Co., 106 Wash. 458, 180 Pac. 479; *Drake v. Missouri State Life Ins. Co.*, (C. C. A. 8th 1927), 21 Fed. (2d) 39.

ISSUE II

Legal Delivery of Policy to Rogers Was Essential to Consummation of Insurance Contract.

(a) *Delivery of the policy was by terms thereof condition precedent to contract.*

It was provided in the application which was annexed to the policy (93):

“It is mutually agreed as follows: 1. That the insurance hereby applied for shall not go into force unless and until the policy is delivered to and received by the applicant * * during his life time.”

There is no question but that Rogers and appellant had the right to agree that the insurance applied for should not become effective until the happening of a certain event, to-wit, the delivery of the policy to Rogers. As stated in Vol. 29, Amer. Jur. at page 164: “Unless it is waived, delivery is also essential where the parties agree and the application or policy provides that the contract of insurance shall not be complete until delivery of the policy. Accordingly, where an applicant for life insurance agreed that the policy should not take effect until issued and delivered, the approval of the application and execution of the policy by the insurer creates no liability, in default of its actual delivery.”

In the case of *Curtis vs. Prudential Ins. Co.*, (C. C. A. 4th, 1932) 55 Fed. (2d) 97, the applicant died after the

policy was issued by defendant company but before the policy was delivered to him and before he had paid the initial premium thereon. In referring to that portion of the application which provided that the insurance should not go into force until the policy was delivered and the first premium paid, the court said:

"The validity of the provisions in the application and the policy is unquestioned. Similar provisions have been passed upon by the courts, and, so far as we can find, have been uniformly approved.

* * * While we recognize the force of the contention made on behalf of the plaintiff that forfeitures are not favored at law, yet where there have been no contracts there can be no forfeiture of a contract, and we think this is a case of no contract. None of the conditions precedent especially stipulated as necessary before the contract became binding was ever properly waived by anyone having authority. *Slocum vs. New York Life Ins. Co.*, 228 U. S. 364, 33 S. Ct. 523, 57 L. Ed. 879; *New York Life Ins. Co. v. Fletcher*, 117 U. S. 519; 6 S. Ct. 837, 29 L. Ed. 934; *Hoffman vs. John Hancock Mutual Life Ins. Co.*, 92 U. S. 161, 23 L. Ed. 539; *Philadelphia Life Ins. Co. v. Hayworth* (C. C. A.) 296 F. 339; *Aetna Life Ins. Co. v. Johnson* (C. C. A.) 13 F. (2d) 824; *Dodd v. Aetna Life Ins. Co.* (C. C. A.) 35 Fed. (2d) 673; *Bradley v. New York Life Ins. Co.* (C. C. A.) 275 F. 657."

To the same effect as the above decisions are: *Hruska vs. Prudential Ins. Co.*, 203 Ia. 1165, 211 N. W. 858, 32 *Corpus Juris*, 1123, *Cooley's Briefs on Insurance*, 2nd Ed., Vol. 1, p. 630.

(b) *Appellant's forwarding policy to Rogers through inadvertence and mistake did not constitute legal delivery of policy.*

The law relative to what constitutes a delivery is set forth in 29 Am. Jur. at page 164:

"In the absence of an express provision therefor, the question is not dependent upon, nor does the law require manual delivery to the insured in person if the legal essentials of delivery are present. These essentials, generally speaking, are (1) an intention to part with control of the instrument and to place it in the possession or control of the insured or some person acting for him, and (2) an act evincing such purpose."

A similar test is found in 32 C. J. at page 1126:

"The test of a sufficient delivery is whether the company or its agents intentionally parts with control or dominion of the policy and places it in the control or dominion of the insured or some person acting for him with the purpose of thereby making a valid and binding contract of insurance. The controlling question is not who has the actual possession of the policy, but who has the right of possession."

Applying the foregoing principles to the instant case, there is no question but that appellant was entitled to possession of the policy even though Rogers at the time of his death had it in his possession. No one would argue that there was a legal delivery of a policy which had been stolen from the appellant's files or had been lost

on the street. In each instance there is lacking the requisite intent to relinquish possession of the policy for the purpose of making it a binding contract. As soon as appellant discovered its mistake in mailing the policy it wrote Rogers asking him to return it to the Arizona office. Had Rogers lived and refused to send it back, appellant could have maintained appropriate legal action to regain possession of it. Rogers was in no way misled or prejudiced by appellant's mistake. There was not a scrap of proof adduced at the trial which would sustain a finding that the policy was ever legally delivered to Rogers.

(c) *If policy were delivered to Rogers it was delivered to him in his capacity as appellant's agent and not in his individual capacity.*

There is a striking similarity between the facts in the instant case and the facts in the case of *Urseth vs. Sun Life Assurance Company of Canada*, (C. C. A. 8th, 1941) 119 Fed. (2d) 529. In the *Urseth* case the applicant for the insurance policy in question was, like Rogers, a soliciting agent of the defendant insurance company. Pursuant to his application, the defendant company forwarded a policy to him with a memorandum of instructions not to deliver the policy until the premium was paid. The application which *Urseth* signed provided that the policy should not take effect until the first premium was paid during applicant's life time. Though the defendant company wrote *Urseth* about the policy, he did not pay the premium prior to his death. To avoid the non-payment of premium the plaintiff argued that the court should adopt the settled rule of law in Missouri to the effect that when a policy is delivered to the applicant there is as a matter of law an automatic exten-

sion of credit and a waiver of the requirement that the initial premium be paid. The court refused to apply this rule of law, holding that since the policy was delivered to Urseth in his capacity as an insurance agent he had no right to deliver it to himself as an individual until all the conditions precedent were complied with. The court stated:

“In the present case, the policy came into Urseth’s hands as an agent of the company, and not as one of its insureds. Plaintiff argued that, where the agent is the applicant for the insurance, a delivery to the agent ought to be held to be a delivery to the insured. But such an indistinguishability does not follow, where, as here, an obligation was imposed upon him as agent, in connection with the receipt of the policy, which the company had a right to require of him, and which was his duty under his agent’s contract to perform. Under the memorandum of instructions placed with the policy when it came into his hands, Urseth, as agent, could not legally release the policy to himself, so as to enable it to become effective, until the initial premium was paid. Whatever might be the necessity and justice of creating an estoppel against the company, where an agent has placed a policy in the hands of a third party insured, in violation of his instructions, the wrongful acts of an agent certainly do not compel an estoppel against the company in favor of himself. The law will not permit an agent to profit from his own fraud as against his principal.”

The policy in the instant case was forwarded to Rogers along with other policies which were sent to him as ap-

pellant's agent. Though under the above ruling this might have been a delivery to him as an agent, it was not a delivery to him as an applicant for there was a further condition to be complied with, to-wit, the payment of the premium and the signing of the agreement, before appellant's agents were to relinquish control of the policy. Rogers should not be permitted to profit from his own fraud as against his principal.

(d) *There can be no constructive delivery of a policy when further acts are required of applicant.*

Can it be argued that a legal delivery of the policy was unnecessary? It is a well recognized rule of law that where an application for a policy of insurance has been accepted and a policy issued, then if nothing further remains to be done by the applicant, any disposition of the policy made by the company which evidences an intention to put the policy out of its control and in control of the applicant is sufficient to constitute a delivery (53 A. L. R. 492). Where, however, a policy is not issued as applied for but is mailed to the agent for delivery to the applicant only upon the performance of certain conditions, then, in such case, there can be no constructive delivery. Under these circumstances, an actual physical delivery of the policy is necessary to the existence of a binding contract (123 A. L. R. 907). The United States Circuit Court of Appeals for the Ninth Circuit stated in the case of *Jackson vs. New York Life Ins. Co.*, (C. C. A. 9th) 7 Fed. (2d) 31:

“A policy of insurance is ‘delivered’ to insured when it is deposited in the mails duly directed to insured at his proper address, even though he never receives it, and it is constructively delivered when it

is mailed to an agent unconditionally for delivery to insured, even though the agent does not actually deliver it, *but the rule is otherwise when the policy is mailed to the agent for delivery only on performance of certain conditions.*" (Underscoring supplied)

Cooley states in his briefs on Insurance, 2nd Ed., Vol. 1, pp. 631:

"So, too, if the policy as written does not conform to the application, it cannot become a binding contract until it has been delivered to and accepted by the insured."

Two pertinent decisions which support the conclusion that there can be no constructive delivery in the instant case are: *Kinney v. Northern Life Ins. Co.*, 200 Wash 190, 93 Pac. (2d) 360; and *Long v. New York Life Ins. Co.*, 106 Wash. 458, 180 Pac. 479.

ISSUE III

Rogers' Failure to Pay Initial Premium Prevented Insurance from Going into Effect.

(a) *Rogers was notified that Lindberg was unauthorized to extend credit for payment of initial premium.*

The only testimony in the records relative to the payment of the initial premium was appellee's statement that Mr. Lindberg told her that he had entered into a credit arrangement with Rogers to pay the premiums out of future earnings (185). As the application and the policy provided that the insurance should not go into force until the first premium was paid in full, it was vital to the existence of appellee's case that she prove

that appellant authorized Lindberg to waive this requirement that the initial premium be paid. This she completely failed to do.

The evidence disclosed that it was the appellant's practice to accept nothing but cash in payment of premiums (204, 209, 210). The Book of Instructions which was given to Rogers stated that this was the company's rule (134). Furthermore, the application which Rogers signed not only provided that the insurance should not go into effect until the first premium was paid in full, but also advised Rogers that only certain designated officers of appellant could waive or modify the terms of the application (94-95). Lindberg, not being one of these officers, had no authority to waive the requirement that the initial premium be paid in cash. He so testified at the trial. (202)

It is horn book law that a principal is not bound by the acts of his agent where such acts are not within the scope of the agent's authority. It never has been and it cannot be the law that a principal is bound by the acts of an agent which are not only unauthorized but are directly contrary to the authority conferred. The only exception to this rule is that created by the law of estoppel. Where, however, the third person dealing with the agent has notice of the limitations placed on the agent's authority, there can be no question of estoppel involved.

The courts are in accord in holding that an applicant is put on notice of the limitations on the agent's authority which were set forth in the application. In the case of *New York Life Ins. Co. vs. Horton* (C. C. A. 5th, 1925) 9 Fed. (2d) 320, the agent delivered a policy to

the applicant's husband, knowing that the applicant had become ill subsequent to the filing of her application. The court, after quoting the provisions of the application limiting the powers of the agent and also portions of the Book of Instruction which were given to all agents of New York Life Insurance Company, said:

"The plaintiff when acting for his wife in dealing with Hines (the agent) in reference to the insurance applied for, was chargeable with notice of the restrictions or limitations on the latter's authority to deliver the instrument sent to him, with the result that, if Hines parted with the instrument when he was not authorized to do so, his act was no more effective against the defendant than it would have been if the plaintiff had actually known of the agent's lack of authority."

The case of *New York Life Ins. Co. v. Fletcher*, 117 U. S., 519, 29 L. Ed. 934, is authority for the proposition of law that an applicant is presumed to have read his application and to have known the contents thereof. Such a rule can be applied with even greater effectiveness to the facts of the instant case, for here the applicant was engaged in the business of selling life insurance policies for the appellant and presumably was well acquainted with its regulations. Certainly Rogers' position does not have the same appeal to our sympathies as that of the typical layman. In fact, it is difficult to find any equities in his favor, for, in addition to the application, the Book of Instructions advised him that: "The Company will accept cash only in payment of a first premium." (137) There was no evidence that appellant was guilty of any conduct which would lead Rogers to believe that the application and Book of Instructions did not mean what

they said. Nor was there any evidence that appellant held out Lindberg as having authority to alter terms of the applications or waive the established rule that the first premium be paid in cash.

(b) *Appellant was not bound by Lindberg's attempted waiver of requirement that such premium be paid in full.*

The application itself expressly limited Lindberg's authority for it stated that only certain designated officers could waive or modify its terms. The United States Supreme Court has held that where an agent's authority to waive conditions is expressly limited by the policy, such limitations govern. *Northern Assurance Co. v. Grand View Bldg. Ass'n.*, 183 U. S. 308, 46 L. Ed., 213, *N. Y. Life Ins. Co. v. Fletcher*, supra.

In a host of decisions involving an attempted waiver of the first premium the courts have given the nonwaiver clause its intended legal effect. In *Aetna Life Ins. Co. v. Johnson*, (C. C. A. 8th, 1926) 13 F. (2d) 824, the court, in holding that an agent was not authorized to deliver a policy on insured's oral promise to pay the premium within a few days, stated:

"It is a rule generally adopted in the United States courts that, if a policy of life insurance provides that it is not to take effect until the first premium is paid, recovery cannot be had upon the policy, when it appears that the premium was unpaid at the date of the death of the insured, unless it appears that payment was waived by action of the insuring company.

"A waiver of this requirement cannot be made by an agent of the insurance company, when the policy provides that no person except other designated officers of the insurance company may alter or waive any provision of the policy, unless the insuring company has authorized the waiver to be made."

In *MacKelvie v. Mutual Ben. L. Ins. Co.* (C.C.A. 2nd, 1923) 287 Fed. 660, where the agent delivered a policy contrary to instructions and gave the insured a receipt before the premium was paid, the court decided that there was no waiver:

"The law is settled in this court that, when a life insurance policy contains, as this one did, the provision that it 'will not take effect, unless the first premium or agreed installment thereof shall be actually paid during the lifetime of the insured,' the provision means exactly what it says and will be enforced. And if the policy contains, as this one did, the express provision that 'agents are not authorized to make, alter or discharge contracts', the waiver relied on must be one by the company itself, and no attempted waiver by an agent will be treated as its equivalent. In *Pennsylvania Casualty Co. v. Bacon*, 133 Fed. 907, 67 C. C. A. 497, a policy of insurance stated that it was not to take effect 'unless the premium is actually paid previous to any accident upon which claim is made,' and it provided that no waiver should be binding on the insurer unless indorsed on the policy and signed by the president or secretary of the company. This court held that a subagent had no authority to accept

a note in lieu of cash for the first premium, and to thereby waive the provisions of the policy. The decisions of the Supreme Court in *Northern Assurance Co. v. Grand View Building Association*, 183 U. S. 308, 22 Sup. Ct. 133, 46 L. Ed. 213; *Penman v. St. Paul Fire and Marine Ins. Co.*, 216 U. S. 311, 30 Sup. Ct. 312, 54 L. Ed. 493; *Aetna Life Insurance Co. v. Moore*, 231 U. S. 543, 34 Sup. Ct. 186, 58 L. Ed. 356; *Lumber Underwriters v. Rife*, 237 U. S. 605, 35 Sup. Ct. 717, 59 L. Ed. 1140; *Mutual Life Ins. Co. v. Hilton-Green*, 241 U. S. 613, 36 Sup. Ct. 676, 60 L. Ed. 1202 — support the same doctrine. The provisions that a policy of life insurance shall not take effect unless the first premium is actually paid in cash during the lifetime of the person insured is valid and will be enforced according to its terms.”

The Supreme Court of Georgia held in *Penn. Mut. Life Ins. Co. v. Blount*, 33 Ga. App. 642, 127 S. E. 892:

“The agreement signed by the assured in his application, ‘that neither agents nor examiners have any authority to modify or enlarge contracts,’ and the clauses in the policy that ‘no alteration of this policy or waiver of any of its conditions shall be valid unless indorsed thereon and signed by an officer of the company,’ and that ‘no agent is authorized to modify, alter, or enlarge this contract,’ placed the assured upon notice that the agents of the company were without any authority to put the policy in force unless the first premium thereon was actually paid during his lifetime and good health. The limitations as thus expressed applied to all agents, including general agents. A principal may qualify

the authority even of a general agent, and will not be bound by acts of such agent beyond the scope of this authority, where the person dealing with him has notice of the limitations thereon."

The applicant in the case of *Bradley v. New York Life Ins. Co.* (C. C. A. 8th, 1921) 275 Fed. 657, attempted to pay the initial premium by giving his note to the agent under an agreement that the agent would personally pay the premium and look to the note. The application, as in the instant case, provided that the payment of the first premium was a condition precedent to the insurance taking effect, and further, that only certain designated officers of the company could modify the terms of the application. The policy was issued as applied for and forwarded to the local agent, but as he was informed of the applicant's death before delivering it, he returned it to the company. The court, in holding that there was no liability, stated:

"The transaction between Bradley and Reaser, the agent, whereby a note was given for the premium must be held to have been a private arrangement between Reaser and Bradley concerning which the company had no knowledge and which was in direct violation of the rules of the company and the instructions given to the agent. So far as the company is concerned, the record shows no arrangement whereby anything but cash should constitute a valid payment of the first premium. It must be conceded that there was no manual delivery of the policy to Bradley in his lifetime or good health, or at all."

The application which the court considered in the case of *New York Life Ins. Co. v. McCreary* (C. C. A.

8th, 1932), 60 Fed. (2d) 355, was identical with the one in the instant case. It provided that in order for the insurance to become immediately effective the applicant would have to pay the first premium in cash, receive from the agent a receipt form, and sign a declaration stating that she had paid the premium to the agent. Though the applicant did pay the premium to the agent, she did not comply with the other conditions of the application. It will be remembered that Rogers also did not comply with the conditions relative to receiving a premium receipt or declaring in the application that he had paid the premium. The Circuit Court of Appeals for the 8th Circuit held that the insurance was not in force, stating:

“She was therefore charged with notice and knowledge thereof, and they were in the nature of conditions precedent, the fulfillment of which were required by the insurance company before it either became or agreed to become an immediate insurer on the life of the applicant. *Jensen v. New York Life Insurance Company* (C. C. A. 8) 59 F. (2d) 957; *Inter-Southern Life Ins. Co. v. McElroy* (C. C. A. 8) 38 F. (2d) 557, 559; *Person v. Aetna Life Ins. Co.* (C. C. A. 8) 32 F. (2d) 459, 460; *New York Life Ins. Co. v. Horton* (C. C. A. 5) 9 F. (2d) 320; *St. Louis Architectural Iron Co. v. New Amsterdam Casualty Co.* (C. C. A. 8) 40 F. (2d) 344; *Clements v. Preferred Acc. Ins. Co.* (C. C. A. 8) 41 F. (2d) 470, 76 A. L. R. 17; *Niagara Fire Ins. Co. v. Pospisil* (C. C. A. 8) 52 F. (2d) 709; *Aetna Life Ins. Co. v. Johnson* (C. C. A. 8) 13 F. (2d) 824; *MacKelvie v. Mutual Life Ins. Co.* (C. C. A. 2) 287 F. 660.

At page 358, the Court states:

“It is contended that these conditions were waived because of the acts and knowledge of the defendant’s soliciting agent. It is, however, to be observed that the application signed by the applicant contained specific provisions that only the president, a vice president, a second vice president, a secretary or the treasurer of the company could waive any of the company’s rights or requirements. The principles of the general law of agency are applicable to insurance companies and their agents (*Globe Mutual Life Ins. Co. vs. Wolff*, 95 U. S. 326, 24 L. Ed. 387). And insurance companies, unless inhibited by valid statutory provisions, may limit the authority of their agent by agreement contained in the application for insurance, and such agreements are binding upon the applicant. *Aetna Life Ins. Co. v. Moore*, 231 U. S. 543, 34 S. Ct. 186, 58 L. Ed. 356; *Northern Assurance Co. v. Grand View Bldg. Ass’n.*, 183 U. S. 308, 22 S. Ct. 133, 46 L. Ed. 213; *Jensen v. New York Life Ins. Co.* (C. C. A.) 59 F. (2d) 957; *Inter-Southern Life Ins. Co. v. McElroy* (C. C. A.) 38 F. (2d) 557; *Curtis v. Prudential Life Ins. Co.* (C. C. A.) 55 F. (2d) 97 * * *

“The applicant, of course, is charged with notice of the agent’s want of authority, and hence no resort can be had to the doctrine of apparent, ostensible, or implied authority. *New York Life Ins. Co. v. Fletcher*, 117 U. S. 519, 6 S. Ct. 837, 843, 29 L. Ed. 934; *Jensen v. New York Life Ins. Co.* (C. C. A.) 59 F. (2d) 957; *Slocum v. New York Life Ins. Co.*, 228 U. S. 364, 33 S. Ct. 523, 527, 57 L. Ed. 879, Ann. Cas. 1914D, 1029.”

Other pertinent decisions involving similar facts and similar rulings are: *Etenburn vs. Metropolitan Life Ins. Co.*, 118 Okla. 55, 246 Pac. 383, *Braman v. Mutual Life Ins. Co. of N. Y.* (C. C. A. 8th, 1934) 73 Fed. (2d) 391.

In view of the foregoing decisions it is immaterial that Lindberg, instead of being a soliciting agent, was the Director of appellant's Arizona Agency. If we are going to give any legal effect to a clause providing that only certain officers can waive conditions of the application, the rank of the agent attempting to make such waiver can have no bearing on the question if, in fact, he was forbidden to waive. In short, there is nothing present in the fact situation before the court which would justify forsaking the well established principles of agency and contract law.

In spite of the persuasive decisions which have been discussed herein it should be pointed out that there are cases which give rather plausible support to the argument that an agent is not bound by the limitations which have been placed upon his authority. Broadly speaking, the courts do not agree on the effect of a provision in an application limiting the power of an insurance agent to waive the conditions therein. Some of this lack of harmony in the decisions may be explained by the fact that each policy has a differently worded non-waiver provision. The real cause, however, is that a wide variety of fact situations arise under these provisions. They involve waiver and estoppel in various forms — such as the general course of business between the insured and the agent, or knowledge of the agent before issuing the policy that there was other and undisclosed insurance or that there was some condition which would

render the policy void by its terms. As an example, the agent may, after a claim arises, absolutely deny liability, and the insured because of such denial, may fail to file the necessary proofs of loss. These various situations, however, all contain the elements of estoppel. (It is well to keep in mind that the doctrine of waiver differs little from estoppel, and the terms are used interchangeably in this field of the law.) It is not surprising, therefore, that the courts, in some instances, hold the non-waiver provision to be ineffective. It is to be expected that when an agent accepts premiums knowing of the breach of some condition which renders the policy void, the court will not sympathize with a company which has continued to collect premiums on a policy which it now contends was void *ab initio*. As a result courts fall back on the rule that knowledge of the agent is knowledge of the company; and that in spite of the non-waiver clause the company, by its conduct, has estopped itself from contending that there could be no waiver.

It is common practice for text writers and courts to quote the general language of another court and completely ignore the facts on which such language is based. The result is that there has emerged from these diversified fact situations many broad statements of law to the effect that a non-waiver clause may itself be waived. In almost every instance the cited decisions merely propound the rule that a non-waiver clause will not prevent the ordinary laws of estoppel from taking effect.

The danger of indulging in such generalities is obvious when one considers how the equities vary in each case. It is difficult, however, in the instant case to dis-

cover the existence of any equities in favor of Rogers. It is true that a mistake was committed in appellant's office routine, but this gives rise to no equities in his favor for he was advised of the mistake before his death. As he was engaged in the insurance profession, he was well aware of the limitations appellant placed on the authority of its agents. There is no reason whatever for applying the doctrine of estoppel, and therefore the court would not be warranted in placing appellant, who necessarily must act through agents, in the anomalous position of not being able to restrict the authority of such agents.

ISSUE IV

Scope of Lindberg's Apparent Authority Was not Proper Subject for Jury's Consideration When Evidence Disclosed Rogers' Knowledge of Limitations on Lindberg's Actual Authority.

Plaintiff's instruction Number One charges the jury that appellant is bound by Lindberg's act in waiving the payment of the first premium if appellant knowingly held Lindberg out to the world as having such authority and if Rogers believed Lindberg had such authority. Plaintiff's instruction Number Two correctly states the abstract principles of the law of estoppel and apparent authority but, like plaintiff's instruction Number One, it assumes that there was evidence that appellant had held Lindberg out to the public generally as having authority to waive conditions in the application and that Rogers was thereby misled. There was no such evidence introduced at the trial; in fact, all the evidence was directly contrary to the facts assumed in these instructions. Since it was proved that Rogers had actual notice

of the limitations on Lindberg's authority, it was highly prejudicial to permit the jury to consider any question of apparent authority.

In the case of *Wells vs. Prudential Ins. Co.*, 239 Mich. 92, 214 N. W. 308, it was the contention of the defendant company that the policy was delivered to applicant merely for inspection and that no premium had been paid. In reply to the plaintiff's attempt to prove that the agent had agreed to extend credit for the payment of the first premium, the court referred to the limitations on the agent's authority which were contained in the instructions, stating:

"An insurance company may limit the authority of its agent. If it holds him out or gives him apparent authority beyond such limit, it is nevertheless bound by his acts within such apparent authority. But no such question is before us. The agent was not upon his record clothed by his principal with an apparent authority to change and modify the terms of the policy. The policy affirmatively established the contrary. In Mr. Wells' written application it was agreed that the contract of insurance should not be enforced until the first premium was paid, and there is no claim that his signature was fraudulently procured. What is claimed is that there was a contemporaneous parol agreement varying its terms. * * * That insurance companies for their own protection may make such stipulations in their contracts as are here found, that such stipulations are enforceable and may be invoked, has been the settled law of this state for many years. *Continental Life Ins. Co. v. Willets*, 24 Mich. 268; *McIntyre v.*

Mich. State Ins. Co., 52 Mich. 188, 17 N. W. 781; Robinson v. Insurance Co., 76 Mich. 641, 43 N. W. 647, 6 L. R. A. 95; Hale v. Farmers' Mut. Fire Ins. Co. 148 Mich. 453, 111 N. W. 1068; Bowen v. Prudential Insurance Co., 178 Mich. 63, 144 N. W. 543, 51 L. R. A. (N. S.) 587; Christopherson v. Life Ins. Co., 199 Mich. 634, 165 N. W. 793; Randall v. Travelers' Ins. Co., 206 Mich. 418, 173 N. W. 388."

ISSUE V

Rogers' Possession of Policy Which Evidence Showed Was Forwarded to Him by Mistake Did Not Place on Appellant Burden of Proving Why Beneficiary Should Not Recover Judgment.

Instruction No. 3 in effect, charges the jury that a presumption may be considered as evidence. It is admitted that an applicant's possession of a policy acknowledging payment of the first premium raises a presumption that such premium was paid. Though appellee always has the burden of proving all the essential elements of her case, such as delivery of the policy and payment of the premium, this presumption arising from Rogers' possession of the policy placed on appellant the burden of going forward with the evidence. When appellant met the burden by introducing evidence that the policy was mailed by mistake, or was in Rogers' possession as an agent rather than as an individual, and that the premium thereon had not been paid, then the presumption arising from Rogers possession of the policy vanished.

The portion of the instruction reading: "The burden of proof falls on the defendant to establish some reason

regarded by law as good and sufficient why plaintiff should not recover judgment in this action" is a palpably incorrect statement of the law and is hopelessly vague and confusing.

ISSUE VI

Appellant Had Right to Designate Manner in Which Its Counteroffer Should Be Accepted by Rogers. (Appellee's Instruction No. 4)

The portion of the application which pertained to aeronautical activities contained this question (98): "To what extent do you contemplate making use of any aircraft and in what capacity?" In answer to this question Rogers stated: "I *wave* all insurance." In view of the fact that the type of policy Rogers was applying for would pay his beneficiary the face value in the event of Rogers' death while riding in or operating an unlicensed aircraft, a very serious ambiguity was raised by Rogers' statement: "In case of accident I *wave* all insurance." Does it refer to all accidents, accidents in any type of aircraft, or only accidents in an unlicensed aircraft? In any event, appellant was under no obligations to accept Rogers' ambiguous application, and it was certainly at liberty to embody in its counter-offer such terms as it felt were necessary to protect itself against possible disputes arising over interpretation. The existence of Rogers' ambiguous statement does not alter the fact that the appellant did not issue the type of policy he applied for. Rogers' beneficiary under the policy appellant issued was entitled to receive the reserve value in the event of Rogers' death in an unlicensed aircraft and the face value in the event of his death in a licensed passenger aircraft. No one can deny that Rogers, if he so desired, had the right to refuse to accept a policy

which incorporated new provisions. It is elementary that a person in making an offer may indicate the manner in which it must be accepted (12 Amer. Juris. page 537, Sec. 44) and unless an acceptance is made in that manner there is no contract. Plaintiff's requested instruction No. 4, in stating that appellant had no right to do this, was highly prejudicial.

That portion of the instruction which reads: "and if you find all other necessary facts in favor of the plaintiff, you are instructed that plaintiff is entitled to recover," is so vague that it is completely unintelligible, for the jury was not advised as to what "all other necessary facts" were.

CONCLUSION

We submit that the judgment of the District Court is most unjust. It severely penalizes appellant for committing a routine error in the forwarding to one of its agents a policy on such agent's life. Appellant acted promptly in attempting to correct its mistake with the result that the agent was in no way prejudiced thereby. Aside from the fact that the evidence disclosed that the appellant and the applicant never agreed on the terms of the insurance contract, it further disclosed that the applicant who was well aware of appellant's rules attempted to obtain from an unauthorized agent of appellant's an extension of credit for the payment of the first premium. It is the essence of unfairness to hold that such facts give rise to legal liability on the part of appellant.

Respectfully submitted,

ELLINWOOD & ROSS,
JOS. S. JENCKES, JR.,
EVERETT M. ROSS,

IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

APPELLEE'S ANSWERING BRIEF

DOUGHERTY & CHANDLER,
M. J. DOUGHERTY,
JOHN FRANCIS CONNOR,

516-19 Heard Bldg.,
Phoenix, Arizona,
Attorneys for Appellee.

FILED

OCT 30 1941

WILLIAM P. O'BRIEN

TOPICAL INDEX

Statement of Pleadings and Facts on Basis of Jurisdiction.....	1
Appellee's Statement of the Case.....	2
Appellee's Argument.....	12
Issue I—Reply thereto.....	12
Issue II—Reply thereto.....	18
Issue III—Reply thereto.....	30
Answer to Appellant's Objection to Instructions.....	66
Issues IV, V and VI, and replies thereto.....	67
Issue IV.....	67
Issue V.....	71
Issue VI.....	73
Conclusion	75

TABLE OF AUTHORITIES

Adams v. Clark, 9 Cush. (Mass.) 215, 57 Am. Dec. 41.....	60
Adams Express Co. v. Harris, 120 Ind., 73 21 N. E. 340, 7 L. R. A., 214.....	60
Aetna Life Ins. Co. v. Geher, 50 Fed. (2d), 659.....	21, 48, 55, 64
Arntsen v. Sheldon First Nat'l. Bank, 167 N. W., 760, L. R. A., (1918F), 1038.....	61
Bailey v. Bailey, 67 Vt., 32 At. 470, 48, Am. St. R., 826.....	61
Barney v. Bliss, 1 D, Chip (Vt.) 399, 12 Am. Dec. 696.....	60
Bell v. Campbell, 123 Miss., 1, 24 S. W., 359, 45 Am. St. R., 505.....	60
Berliner v. Travellers Ins. Co., 53 Pac., 922.....	21, 55

Bloom v. Pac. Mut. L. Ins. Co., (Calif. 1927), 259 Pac., 496.....	16, 55, 74
Buckley v. Citizens Ins. Co., 188 N. Y. 399, 81 N. E., 165, 13 L. R. A., (N. S.) 889.....	42
Capital Livestock Ins. Co. v. Campion, 204 Pac., 604.....	36, 51
Cleveland, etc. R. Co. v. Anderson Tool Co., 103 N. E., 102, 49 L. R. A. (N. S.) 749.....	60
Columbia Bank v. Hagner, 1 Pet. 455, 7 L. Ed. 219.....	57
Columbia Hts. Realty Co. v. Rudolph, 217 U. S. 547, 54 L. Ed., 877.....	74
Cranston v. West Coast Life Ins. Co. 72 Ore., 116, 142 Pac., 762.....	52
Crooker v. Holmes, 65 Me., 195, 20 Am. Rep., 687.....	47
DeFrece v. Nat'l. L. Ins. Co., 32 N. E., 556.....	72
DeWolf v. Johnson, 10 Wheat. 367, 6 L. Ed., 343.....	58
Edwards v. Culbertson, 111 N. C., 342, 18 L. R. A., 204.....	61
Ecualyptus Growers v. Orange County Nursery, 163 Pac., 45.....	21
Farnum v. Phoenix Ins. Co., 83 Cal., 246.....	55, 64
Fore v. Hitson, 8 S. W., 292.....	68
Gamachae v. Piquinot, 16 How., 451, 14 L. Ed., 1012.....	74
Garvey v. Jarvis, 46 N. Y., 310, 7 Am. Rep., 335.....	61
Gay v. Parpart, 106 U. S. 679, 27 L. Ed., 256.....	32
Grant v. Groshon, 3 Am. Dec. 725, and (12 Am. Dec. 575, Notes).....	57
Grimes, v. Sanders, 32 L. Ed., 798.....	26
Hanover Nat'l. Bank v. Am. Dock Co. 43 N. E. 72, 51 Am. St. R., 721.....	70

Hartford L. Ins. Co. v. Hayden's Adm'rs., 90 Ky., 39, 13 S. W. 585.....	34
Hartwig v. Aetna L. Ins. Co. 158 N. W. 280.....	52
Harris v. Sec. L. Ins. Co. (Ann. Case 1914C), 648.....	63
Haskell v. Starbird, 25 N. E., 14.....	68
Heinlen v. Heilbron, 97 Cal. 101, 31 Pac., 838.....	48
Hinkson v. Kansas City L. Ins. Co., 93 Ore., 473, 183 Pac., 24.....	52
Hitchman Coal & Coke Co., v. Mitchell, 254 U. S., 29, 62 L. Ed. 260.....	32
Holloway v. Dunham, 170 U. S., 615, 42 L. Ed., 1165.....	74
Home Ins. Co., v. Gilman, 112 Ind., 7.....	72
Hughey v. Smith, 133 Pac., 68.....	21
Kentucky Home L. Ins. Co. v. Johnson, 93 S. W., 863.....	35
Knickerbocker L. Ins. Co. v. Norton, 96 U. S., 234, 24 L. Ed. 689.....	49
Lawrence v. Penn. Mut. L. Ins. Co., 36 So., 398.....	42
Magnolia Compress Co. v. Dennis, 19 S. W., (2d), 339.....	26
Mfg'rs, etc. Co. v. Armstrong, 45 Ill. App., 217.....	70
Mauch v. Merchants, Etc., 54 At. 952.....	72
McAllister v. New Eng. Mut. L. Ins. Co., 101 Mass., 558, 3 Am. Rep. 494.....	42
McConnell v. So. States L. Ins. Co., 31 Fed., (2d), 715.....	49
McCullough v. Scott, 13 D. Mon. (Ky.) 172, 56 Am. Dec., 561, and Note.....	59
Metropolitan L. Ins. Co. v. Williamson, 174 Fed., 116.....	49
Michiloff v. Am. Cent. Ins. Co. 128 At., 33.....	51

Mich. Mut. L. Ins. Co. v. Custer, 128 Ind. 255, 46 At., 1005.....	72
Miller v. Brooklyn L. Ins. Co., 12 Wall., U. S. 285, 20 L. Ed. 398.....	42, 64
Morris v. Joseph, 1 N. W., 256, 91 Am. Dec. 386.....	61
National Mut. Fire Ins. Co. v. Sprague, 92 Pac., 227.....	21
New Eng. Mut. L. Ins. Co. v. Springgate, 113, S. W., 824.....	35
No. Am. Acc. Ins. Co. v. Whiteside, 134 Ill. App., 290.....	52
Norton v. Ins. Co., 96 U. S., 234.....	70
N. Y. L. Ins. Co. v. Fletcher, 117 U. S., 519, 29 L. Ed. 934.....	17
N. Y. L. Ins. Co. v. Silverstein 53 Fed., (2d), 986.....	40, 47
Nunez v. Dautel, 19 Wall., 560, 22 L. Ed., 161.....	47, 56
Ollich v. N. Y. L. Ins. Co., 42 Fed., (2d), 399.....	49
Page v. Virginia L. Ins. Co., 42 S. W., 543.....	72
Penn. Mut. L. Ins. Co. v. Blount, 33 Ga., App. 642, 127 S. E. 892.....	53
People v. McCauley, 1 Cal., 379.....	74
People v. Doyle, 48 Cal., 85.....	74
People v. McCurdy, 68 Cal., 576, 10 Pac., 207.....	75, 76
People v. Torcott, 65 Cal., 126, 34 Pac., 618.....	74
Peoples L. Ins. Co. v. Whiteside, 94 Fed., (2d), 409.....	17
Pointer v. Ind. L. Ins. Co., 30 N. E., 876.....	72
Public Savings Ins. Co. v. Manning, 111 N. E., 945.....	51
Rayburn v. Pac. Cas. Co., 50 S. E., 762, 107 Am. St. R. 548.....	72
Richardson v. Brotherhood L. F. E., Soc., 122 Pac., 82, 41 L. R. A. (N. S.), 320.....	51

Robinson v. Pierce, 118 Ala., 273, 24 So., 584, 45 L. R. A., 66.....	61
Rosebrough v. Tigard, 252 Pac., 75.....	51, 52
Sargeant v. Adams, 3 Mass., (Gray), 72, 63 Am. Dec., 718.....	56
Schwartz v. No. Life Ins. Co., 25 Fed. (2d), 555; (Certiorari denied), 73 L. Ed., 547.....	49
Smith v. Wise, 58 Ill., 141.....	68
Snyder v. Nederland L. Ins. Co., 202 Pac., 161, 51 At., 744.....	36, 37
State v. Minn. Land Imp. Co., 50 Pac., 420.....	21
Stephenson v. So. Pac. Co., 102, Cal., 143, 34 Pac., 618.....	75
Travellers Ins. Co. v. Jones, 73 S. W., 978.....	26
Union L. Ins. Co. v. Haman, 74 N. W., 1090.....	36
U. S. L. Ins. Co. v. Lesser, 28 So. Rep., 646.....	70
Urseth v. Sun L. Ins. Co. of Canada, (CCA 8th 1941), 119 Fed. (2d), 529.....	27, 28
Vance v. Anderson, 113 Cal., 532, 45 Pac., 816.....	32
VanWerden v. Equ. L. Assur. Soc., 68 N. W., 892.....	51
Washburn v. Union Cent. L. Ins. Co., 39 So. Rep., 1011.....	72
Wells v. Pru. Ins. Co., 239 Mich. 92, 214 N. W. 308.....	69
Wheeler v. Holloway, 276 S. W., 653.....	26
Whipple v. Pru. L. Ins. Co., 222 N. Y., 29, 118 N. E., 211.....	52

TEXTS

Abbott's Trial Evidence, Vol. 2, page 1242.....	72
Am. Juris. Vol. 19, Sec. 58, page 78.....	26
Am. Juris. Vol. 29, Sec. 821.....	50

Appleman on Ins. Law and Prac. Vol. 1, Sec. 131, page 121.....	55
Appleman on Ins. Law and Prac. Vol. 1, page 174, Sec. 172.....	17
Branson Inst. to Juries, 182.....	68, 70
Corpus Juris, Vol. 32, Sec. 44, page 1271.....	26
Corpus Juris, Vol. 21, Sec. 165, page 183.....	30
Corpus Juris, Vol. 26, page 329.....	52
Corpus Juris, Vol. 33, Sec. 858, page 126.....	63
Couch on Insurance, Vol. 3, Sec. 633, pages 2028 - 2029	50
Couch on Insurance, Vol. 2, Sec. 514.....	50
Hayne New Trial and Appeal, Rev'ed, Vol. 2, Sec. 288, page 1622.....	48
Ruling Case Law, Vol. 6, Sec. 239, Page 849; Sec. 241, page 852.....	42
Ruling Case Law, Vol. 14, Sec. 1183, 1184.....	52
Ruling Case Law, Vol. 21, Sec. 8, page 15.....	57
Ruling Case Law, Vol. 10, Sec. 139, page 389.....	58
Vance on Insurance, Vol. 1, page 178.....	49

STATUTES

Chapter 20 Rev'ed Code Arizona (1928), Par. 978.....	56
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IN THE
United States
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NEW YORK LIFE INSURANCE COMPANY, a
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Appellant.

vs.

LOIS ROGERS,

Appellee.

APPELLEE'S ANSWERING BRIEF

Statement of Pleadings and Facts disclosing Basis
for Jurisdiction.

Appellee accepts Appellant's Statement of Pleadings
and Facts disclosing basis for jurisdiction.

APPELLANT'S STATEMENT OF THE CASE

Counsel for Appellee is unable to accept Appellant's
Statement of the Case as set forth in their opening brief

for the reason that such statement is fragmentary, incomplete, does not present succinctly the questions involved, or the manner in which they are raised, and does not constitute a sufficient abstract or correct statement of the questions involved, or the manner in which they are raised, and, therefore, with no disrespect to opposing counsel, feels obliged to present their own case statement.

APPELLEE'S STATEMENT OF THE CASE

(References in Statement of the Case are to the Transcript of Record)

1. Defendant's Arizona Office Personnel.

(a) Mr. Arthur F. Lindberg at all times herein involved, was Chief Executive and General Manager of the Arizona Office of the New York Life Insurance Company - Defendant and Appellant in this case; and as such, had general direction and control over the company's business, (Mr. Lindberg Tr. 81-85): Mr. D. F. Caskey, during the same period, acted as Cashier of the company in the Phoenix Office, and as such Cashier, received and mailed to the respective agents or insured, life insurance policies issued by the company in the State of Arizona, (Tr. 79-81).

2. Defendant's Local Office Customs, Routine and Practice.

(a) The insurance company has in its local office a printed "Pamphlet" relating to policies, entitled "Instructions to Agents", concerning various practices, (Def's Ex. "F", Tr. 134), but there is no proof that such Pamphlet or any other prepared office regulation respecting the issues of this case, were ever given by any authorized company official, to Rogers, the insured, (Tr. 133); or that the

provisions of the "Pamphlet" are observed in actual office practice.

(b) Under the actual routine practices of the company, applications for policies are solicited by, and then sent by salesmen, to the local Phoenix Office, from which they are regularly forwarded to the New York Home Office, which in turn, rejects or accepts the application and issues or refuses the insurance policy. When the application is accepted the policy is sent to the Phoenix Office, and the Phoenix Office either delivers the policy direct to the insured, or to the agent who has solicited the insured, (Tr. 83, 103-106, 143, 144).

3. Delivery of Policies Under Company Credit System.

(a) Where the initial premium has not already been collected at the time of signing the application, the agent collects such initial premium, and in due time usually remits the same to the Phoenix Office; whereupon, he is credited on the local office account books, and is chargeable with any cash premiums retained.

(b) Life insurance policy recitals suggest that the initial premiums must be paid in cash before the delivery of the policy, but in actual practice, the provision is customarily and usually disregarded, and there is set up by common practice an indirect policy Credit Arrangement. Under this arrangement the soliciting agent may sell policies on a time basis - accepting promissory notes or other evidence of indebtedness for the initial premium, and deliver the policy to the insured without the payment of the initial premium in cash, (Tr. 143-144, 158).

(c) Out of the first and subsequent accruing premiums, the selling agent retains or is credited with a cer-

tain commission or stipend for his services. The agent usually collects these premium notes as they mature and remits to the branch office or retains the collection - dependent upon the status of his credit account or arrangement with the local office of the company. The initial payment promissory notes, represent the amount of the initial premiums due on the appertaining policy, plus the commission due to the salesman, (Tr. 157-158).

4. Employment of Rogers as Salesman.

(a) October 28, 1939, Zeno A. Rogers, in his lifetime the husband of Lois Rogers, the Plaintiff and Appellee herein, was employed in the capacity of salesman by the Defendant Company, acting in this regard, by its Arizona Branch Manager, Mr. Lindberg, (Tr. 83-84).

(b) Pending the receipt of the earnings, it was necessary for Mr. Rogers, then in straightened circumstances, to borrow operating expense money; and an arrangement was made between Mr. Lindberg for the New York Life Insurance Company, Zeno A. Rogers and one Stanley Clem, of Phoenix, whereby the said Clem, loaned Rogers the sum of Seventy-Five Dollars (\$75.00), to be thereafter repaid to Clem out of commissions or premiums to be subsequently earned by Rogers through insurance policy sales; and which arrangement, was participated in by Mr. Lindberg, for the insurance company, Mr. Rogers and Mr. Clem, (Tr. 174-177; 185; Pltf's Ex. in Evidence No. 5 Tr. 177).

5. Rogers' Policy Sales and Commissions.

(a) Immediately upon the making of employment arrangements (October 28, 1939), the insured Z. A. Rogers, entered upon his work and duties as sales agent

for the company in the southern part of the State, and at a considerable distance from the local office of the company at Phoenix. He continued in such employment as sales agent until his death.

(b) The company kept no record of transactions between it and Zeno A. Rogers during the period of his employment - nor until February 24, 1940, and after his death. It then set up and began keeping an account for him, (Tr. 147).

(c) The volume of his policy sales compared very favorably with those of the larger production agents of the company, (Tr. 59-61; 75-76; Pltf's Ex. No. 1, Tr. 62).

(d) Altogether, Mr. Rogers before his death, sold some thirty-nine (39) policies of which some fifteen (15) policies were subsequently cancelled for non-payment of the first premium promissory note given therefor, and twenty-four (24) were retained in good standing, (Tr. 149, 150).

(e) The record further shows that where Mr. Rogers made sales of policies and took promissory notes of the policy holders for the initial premium, these notes were seized on Rogers' death, and taken by Mr. Lindberg to the Phoenix Office of the company, (Tr. 156-161; 191-194), and of these notes, the company collected thereafter, some \$404.87 - applicable, as per credit arrangements (Sec. 4, Par. (b), ante; Sec. 6, Par. (a), infra), and then upon the various policies Rogers had sold, (Tr. 151). The insurance company office at Phoenix continued to collect on these promissory notes at least, until December, 1940, and returned some of the notes uncollected, to Mrs. Rogers, widow of the insured deceased, (Tr. 191-195).

6. Rogers' Policy Application and Waivers.

(a) About December 1, 1939, and during his employment as salesman the deceased, Zeno A. Rogers, began negotiations for the application or taking out of a New York Life Insurance Company policy on his own life. As he had previously made arrangements between himself, Mr. Lindberg and Mr. Clem whereby the latter, Mr. Clem, was to be repaid the \$75.00 which he had loaned to Rogers for expense money, out of the first commissions earned by Rogers, (See Sec. 4, Par. (b) ante, and as under the new arrangement then being made for the purchase of his own policy on credit, it was proposed that Mr. Clem subordinate his prior claim against commissions earned, in order that the insurance company should receive the proceeds of commissions earned by Rogers. Accordingly, Rogers communicated with Mr. Clem regarding this matter, and Mr. Clem in turn conferred with Mr. Lindberg concerning the subordination of Mr. Clem's prior claim, (Tr. 180-182).

(b) Under the new arrangement agreed upon between Rogers, Clem and Lindberg, it was arranged that Mr. Clem's claim should be subordinated until the initial premium on Rogers' policy had been paid to the company, (Tr. 171-182; 185-186).

(c) Thereupon, about December 7th of that year, and during his employment as salesman, Zeno A. Rogers, applied for an insurance policy on his own life, in the sum of \$2,000.00 or double that amount (\$4,000.00) in the event of death from accidental means other than accidents growing out of or connected with the use of or operation of aircraft - aviation accidents, (Pltf's Ex. No. 3, Tr. 86), and naming as beneficiary under the policy, his wife, Lois

W. Rogers, Plaintiff in this case; and in connection therewith, he executed appropriate Applications and Waivers, (Pltf's Ex. No. 3, (Application), Tr. 92 to 98).

(d) In his application, Rogers, the insured, also agreed that any additions or amendments affixed to the policy were ratified and accepted by him, (Pltf's Ex. No. 3, ante, Tr. 95). He also stated therein, that he was not in any wise connected with aviation, and that in the event of aviation accidents, he waived all insurance.

(e) Rogers' application passed through Mr. Caskey's hands in the Phoenix Office, from which it was regularly transmitted to the New York Home Office of the company, (Pltf's Ex. No. 3, ante, Tr. 95, 97-98; 79-80).

7. Issuance and Transmission of Policy by Home Office.

(a) Rogers' application as transmitted from the Phoenix Office, was accepted by the Defendant insurance company at its Home Office in New York, and a policy dated December 19, 1939, was issued as per application. In accordance with the waiver respecting aviation accidents, appearing in Rogers' application already signed by him, there was attached by the company to the original policy transmitted for delivery to Rogers, what is called a "Permanent Aviation Clause Waiver" to which waiver, was affixed the signature of Rogers typed thereon by the company, (Pltf's Ex. No. 3, ante, Tr. 90-91).

(b) In a certain Inter-office *stock* or routine form, accompanying communication, the incidence of a duplicate of the paper designated as "Permanent Aviation Waiver Clause" is mentioned. No such duplicate so far as the record shows, was ever transmitted from the Home to the Arizona Office of the Company; and the de-

fendant admitted on trial that such a paper could not be found, (Tr. 142).

8. Delivery of Rogers' Policy.

(a) The policy was transmitted to, and received by the Arizona Office about December 23, 1939, (Tr. 108). If, in addition to the "Permanent Aviation Clause", paper or rider affixed to the policy, and having thereon Rogers' name, there was a paper or duplicate paper, containing such clause, it nowhere appears from the evidence.

(b) No such paper was ever presented or mentioned to the insured, Zeno A. Rogers, in connection with the delivery of his policy, or otherwise.

c) Negotiations regarding extension of credit to Zeno A. Rogers for first premium took place between, and were conducted by Messrs. Lindberg, Rogers and Clem, - (See Sec. 6, ante), and not with or by Mr. Caskey - (Tr. 152-153), - although he had notice, (Tr. 152-162), of credit in re: Clem loan, (Tr. 162-163).

(d) Mr. Caskey in his official capacity with the insurance company, regarded the acceptance of Rogers' insurance policy with the aviation clause attached, as a waiver of any insurance claims in the event of an accident from aviation; and also regarded the delivery of the policy as a receipt for the payment of the first premium, (Tr. 140, 156).

(e) Rogers' policy was transmitted from the Home Office accompanied by a *stock* or routine printed form of communication. The subject of this circular related to the waiver with respect to aviation accidents. This was the waiver which Rogers had included and signed in his

application, (See Sec. 6, Par. (c), ante). This *stock* communication was designed to govern situations between salesmen and third parties, and was inapplicable in the instant situation, and was an inter-office direction, the subject matter of which was never communicated to or in any wise brought to the attention or knowledge of Rogers; nor was he ever shown nor asked to sign any such waiver or other instrument, (Tr. 129, 215).

(f) Credit arrangements for the payment of the first premium having been previously made, (See Sec. 6, Par. (a), ante), Rogers' insurance policy was regularly mailed to him by Mr. Caskey on or about December 29th, 1939, and in the ordinary course of mail service between the Phoenix Office and the operating headquarters of Rogers, at Wilcox, and received by him at the latter place about January 1st or 2nd, 1940, and it remained in Rogers' possession until the time of his death, (Tr. 79-81).

(g) Under the local office routine, there is sent to salesmen monthly, a statement showing what policies have been delivered to them in the previous month, and upon which document the agent's report information concerning the policies. Such a statement was sent by Mr. Caskey to Mr. Rogers about January 15th, 1940, recalling to Mr. Rogers, among other things, that his own policy had also been delivered to him. In response to this statement sometime after the 20th of January, 1940, Rogers returned such monthly routine report advising, among other things, that he was holding his own policy, (Def's Ex. D - Tr. 125-126).

(h) Thereafter on January 23rd, 1940, and while the credit arrangement for the premium payment between Messrs. Lindberg, Rogers and Clem was in effect, Mr.

Caskey wrote Mr. Rogers asking the latter to return his policy so that the local office might hold it until the premium was paid, (Def's Ex. "E", Tr. 129). This letter in the ordinary course of mail delivery would have reached Mr. Rogers about January 26, 1940, which was the date of his accidental death.

9. Death of Mr. Rogers.

(a) Mr. Rogers, the insured, maintained headquarters at the Page Hotel, Wilcox, Arizona, about 250 miles from the company's Phoenix Office, and in his room were located his papers, documents and personal belongings.

(b) He was fatally injured in an automobile accident at Fort Huachuca, not far from Wilcox, on the evening of January 26, 1940. His injuries, among other things, consisted of cerebral contusions, broken leg and arm, skull fracture and shock, and he was taken unconscious to the Military Hospital at Fort Huachuca immediately after the accident at which place he died on the morning of January 28th, 1940, (Tr. 75-76).

10. Seizure of Zeno A. Rogers' belongings by Defendant Company.

(a) At the time of the death of Rogers, the insured, Mrs. Rogers was at the family home in Phoenix, Arizona, where she was called by telephone by Mr. Lindberg, State Manager of the defendant insurance company, who stated to her that he proposed to go to Willcox, and wanted permission from Mrs. Rogers to enter the hotel room of her deceased husband. She informed him that she would not give such consent, and that she intended to go "down there" and take charge, and informed the hotel manager by telegram, not to permit anyone to enter her deceased husband's room, (Tr. 185).

(b) Mr. Lindberg, however, went to Willcox, entered Rogers' room in the Page Hotel and took therefrom, all papers and documents belonging to the deceased, including his personal correspondence, papers, documents, insurance policy, promissory notes and all other data therein, and brought the same to the office at Phoenix; and the same, except as otherwise shown by the record herein, are still in possession of the defendant company, (Tr. 76-77; 183-185; 198-199).

11. Company's Repudiation of Insurance Contract and Refusal to give Proof Forms to Mrs. Rogers, the Beneficiary.

(a) Mr. Rogers was buried at Phoenix, Arizona, about February 1st, 1940. Immediately thereafter Mrs. Rogers made demand on Mr. Lindberg, as company manager, for her husband's papers, including the insurance policy in which she was named beneficiary. Mr. Lindberg refused to give her the policy or any other papers taken, saying:

"I had the right because everything in the room pertaining to the company is now the property of the New York Life Insurance Company; therefore, I have the right to take it and I have it", (Tr. 185).

(b) He further stated in answer to her inquiry as to the credit arrangement:

"Yes, that is the way it was supposed to have been, but unfortunately he died before he was able to pay anything on it".

On Mrs. Rogers' further insistence for the return of the policy, he said: "Well, I can't give it to you", (Tr. 185-186).

(c) Subsequently Mrs. Rogers made further demand upon the company through Mr. Lindberg for the necessary forms to make proof of loss. Mr. Lindberg refused to give the forms stating: "That the company would not pay the policy anyway". Her demand was repeated on two other occasions but on each occasion all responsibility on the part of the company was denied and the forms and payment refused, (Tr. 76-78; 183, 185-186).

(d) Thereafter Mrs. Rogers brought this action.

APPELLEE'S ARGUMENT

(References in argument following are to Sections indicated by numbers, e. g. (1), and Paragraphs indicated by letters (a) as appearing in Appellee's Statement of the Case, ante, except where direct reference to the Transcript is indicated by "Tr. p.....").

ISSUE I

Arguing this issue, counsel quotes from 14 RCL, 895, to the following effect:

"To be effective the acceptance of an application must be in the very terms offered. Where it is on different terms the contract is not complete until the applicant has signified his acceptance to the new terms".

Appellee concedes the quotation as a correct statement of abstract law with respect to offer and acceptance, but the proposition finds no foundation or application in the facts or record of this case - - -. Instead the facts and the record conclusively show the inapplicability of the general statement.

Counsel's argument proceeds upon the theory that Rogers applied for one type of policy, and that the company rejected his application, and offered another type, or that

Rogers when so requested, failed to do something which he should have done. *This is not true.* The facts establish the opposite. The record discloses that Rogers applied for an ordinary life policy with double indemnity features for accidental death, except in case of accidents arising from aviation, and he expressly waived all insurance rights or benefits in case of accidental death from aviation causes.

The company accepted his application and waiver with a direct and patent recognition of his waiver, and then affixed to his policy, with his name typed thereon, a condition or rider wherein death benefits from aviation accidents, were expressly waived, (App. St. Sec. 6, Par. (c); Sec. 7, Par. (a), and Rogers' acceptance of the policy in accordance with the Company's long established custom and practice, was his acknowledgment of his acceptance of this policy with the waiver attached, and an express acceptance of the condition and waiver, (App. St. Sec. 8, Par. (d)). Rogers had already signed a waiver of the right to claim insurance benefits in case of accidental death arising from aviation accidents (App. St. Sec. 6, Par. (d) & (e)) - His signing another paper for the same purpose could add nothing to the exemption of the Company. What more could he do? There was also attached to his policy the same waiver with his name typed thereon by the Company, and in accepting his policy, he would obviously accept the condition and confirm the waiver. What more could be required?

It will be conceded that the cases cited by counsel under this issue are consistent with, and support the abstract statement from Ruling Case Law, and it would serve no useful purpose to analyze them, because obviously and for like reasons, they are not in point. They apply only, to a

state of facts actually involving "offer and acceptance".

In the instant case, the Company issued Rogers' policy on his application, which was incorporated in, became part of his policy, and as such contained *precisely the waiver in question* and in recognition of this fact, the Company attached also as a part of the policy issued, a duplicate of the very waiver involved, and typed thereon Rogers' signature of acceptance - - - which signature and acceptance, it necessarily follows, implied consent to the condition.

It is significant that this so-called "Permanent Aviation Clause" discussed under this Issue, first became apparent or received any consideration on the part of the defendant on the trial of this case. Its existence was never established, (App. Sec. 7, Par. (b), ante). In no conversation between Caskey and Lindberg, or between either of them and Rogers, was it ever produced, suggested or mentioned - Even in Caskey's letter to Rogers about January 23, 1940, when the occasion and the circumstances in good faith required him to then mention it - if ever, there was not even an intimation of the existence of such a paper or the necessity of any action on the part of Rogers with reference thereto, (App. St., Sec. 8, Par. (h), ante). From all of these facts and circumstances and the attitude and reaction of Messrs. Lindberg and Caskey in the premises, it is eminently fair to conclude that until Mrs. Rogers brought this suit, these two Company representatives considered the waiver feature fully closed, and the matter of no importance, (App. of Facts, Sec. 8, Par. (d), ante).

When this action was brought, the question of defense first confronted these two Company representatives, and

as they had previously only asserted as justification for the repudiation of the Company policy, the alleged "premature death" of Rogers, as a sole defense against the claim of Mrs. Rogers, it is patently evident that then, for the first time, Mr. Caskey grasped at the possible solace which might be drawn from this *stock* Inter-office communication, and Mr. Lindberg adopted his "line". This, we respectfully submit is not an idle speculation, but is amply supported by the record - Mr. Lindberg did not tell Mrs. Rogers in his conversation with her that her husband had failed to sign any waiver or any other required paper; he only said the Company would not honor the policy or pay the same because her husband had died before he had performed the credit arrangement under which the policy had been delivered to him, (App. Sec. 11, Pars. (a) to (e) incl., ante).

Certainly these facts and circumstances will not sustain counsel's argument of an inconsistency between an offer and acceptance as attempted under this Issue.

If any legal questions are posed by the facts of this case, they are:

Where an applicant has signed and delivered an application for an insurance policy, which application is to become a part of the policy and which contains all Company required waivers; and an insurance policy is issued thereon incorporating such application and waiver, and in addition the exact words used are embraced in a paper likewise incorporated therein, and forming part of the policy to which the Company signs the applicant's name with intention that the policy will be accepted in the form prepared by it - - Is there a further legal essential, that there should be a repetition of this signature and waiver before the policy becomes effective?

It is also to be remembered that this alleged duplicate paper or waiver - or whatever it may be called, was never presented or mentioned to Rogers; that his signature thereto, was never requested; and that it is entirely immaterial.

Are his rights to be prejudiced by such an Inter-office Direction of which he had no knowledge whatever?

We submit that the foregoing questions, - which really comprehend the facts of this case, must both be answered in the negative; and our contention in this regard, is amply supported by the following authorities:

The case of *Bloom v. Pacific Mutual Life Insurance Co.*, (Calif. 1927, 259 Pac. 496) is of interest because it is based upon a fact situation analogous to the matter herein. The question as to the obligation of the insured to sign an additional application and a certificate of health sent along to him with the policy was presented. The Court in rejecting the defendant's contention that such documents should have been signed to make the insurance contract valid, stated at page 500, Col. 2:

"This question was presented and decided adversely to the contention of the Appellant in the case of *Kahn v. Royal Indemnity Co.*, 39 Cal. App. 180, 178 P. 331. Hearing in that case was denied by the Supreme Court. There the policy in question read as follows:

"This policy with a copy of the application therefor signed by the insured, and such other papers as may be attached to or indorsed hereon shall constitute the entire contract between the company and the insured."

"The application was not signed by the insured, and such failure was held immaterial. The policies with which we have to do read as follows:

"In consideration of the application for this policy, a copy of which is attached hereto and made a part hereof," etc.

"The transcript shows, accepting the testimony of Stillman, that typewritten copies of Bloom's application, with Bloom's name typewritten therein in the place where ordinarily the signature of the applicant would be found, accompanied the policies, and under the case which we have cited and the authorities there referred to, the application became and was a part of each policy as fully to all intents and purposes as though actually signed by Bloom".

In view of the facts, as presented, it was unnecessary for Rogers to exercise any overt act to indicate his assent to the aviation waiver clause.

Abstracting from our contention that the failure to sign such waiver clause was immaterial, we assert that the facts permit the implication that the acceptance of the policy was also an acceptance of the "Permanent Aviation Waiver".

Appleman on Insurance Law & Practice, Vol. 1, Page 174, Section 172, supports our contention as follows:

"* * * the courts are quite willing to imply acceptance where the terms of the contract are clear, and it was apparent it would have been accepted" (Note 10, citing *Peoples Life Insurance Co. vs. Whiteside*, 94 Fed., (2nd) 409).

The case of *New York Life Insurance Co. vs. Fletcher*,

117 U. S. 519, 29 L. Ed., 934, cited by Appellant in it's Opening Brief, is further authority for our contention that no overt act was necessary for Rogers to indicate his acceptance of the policy.

We submit that Appellant's statements of law under Issue and Argument No. 1, are correct as abstract statements of law, but they are inapplicable to the fact situation here presented. The facts in the instant case show a meeting of the minds of the contracting parties for the reason that the policy as issued embodied all the essential terms of the contract as proposed and assented to in Rogers' application. His failure to sign the Permanent Aviation Clause was immaterial; he would have agreed to nothing thereby that he had not already assented to in his application.

It will be further noted that the facts in the *Morford* case cited by Appellant, are entirely different. The insured in that case, never received or had possession of the policy. Changes had been made by the Company and the policy was different than requested by the insured. Obviously, if the policy never reached the insured, and if he never even heard of the changes, he was precluded from assenting to or signifying consent to what really was a counter-offer.

ISSUE II

This is also a "feigned" issue—as are its appertaining corollaries (a), (b), (c) and (d). What was said of the inapplicability and lack of pertinency concerning the previous "Issue I", applies with equal force as to this Issue II—Neither bear any reasonable relation to the facts in this case.

To state as an "Issue" as counsel have done, that "Le-

gal delivery of policy to Rogers was essential to a consummation of insurance contract", and as corollaries thereof, that "delivery was a condition precedent, to contract"; that if "appellant delivered the policy to Rogers through inadvertence or mistake", or that delivery to him in a representative capacity, might not be delivery in an individual capacity; or again, that "there can be no constructive delivery of a policy when further acts are required of applicant" - is but to state a truism.

We may well concede the propriety of these abstract propositions of law - We have no quarrel with them, or with the authorities stated in support thereof; but these abstract propositions do not pertinently arise from the facts—There is nothing in the record in this case, that will in any wise indicate the pertinency of these obvious rules of law. Sympathetically viewed, we assume Counsel intended to submit an issue of law *arising from the record*, and asking counsel's indulgence, we interpret such a proposition to be;

No Rights can be Predicted by the Plaintiff, on Possession of Insurance Policy by Rogers, because:

- (a) He failed or refused to perform some required acts, and for that reason, there could be no constructive delivery of the policy.
- (b) It was sent through inadvertence and mistake.
- (c) It was sent to him in his representative capacity.

We will attempt to meet counsel's argument with respect to this Issue as formulated.

(a). Alleged non-performance by Rogers

The facts and record relating to waiver of accidents arising from aviation, were fully abstracted, ante, (App. St. Sec. 6, Pars. (c) & (d); and Sec. 8, Pars. (a), (b) & (e)).

These sections and paragraphs, show that if there ever was "another paper or waiver" transmitted from the Home, to the Arizona Office, such paper nowhere appears from the record; also that this alleged paper or waiver, was *never mentioned or in any wise presented* to Rogers and *no demand was ever made on him, nor was he ever requested* to sign any such paper or additional waiver - - not even in Mr. Caskey's letter of January 23rd, ante, (App. St. Sec. 8, Par. (h)); nor in any conversation detailed by Mr. Lindberg or any other representative of the Company.

Counsel's statement, therefore, that "there could be no constructive delivery of the policy" is beside the question; and irrelevant, because what is involved is an actual delivery which we submit the record abundantly shows. Rogers was guilty of no default or failure with respect to any demands or requests made on him with respect to his policy, and its delivery was actual and without any express or implied conditions.

Discussions of cases cited by counsel dealing with constructive delivery, would be useless since they are patently not in point. The law respecting the legal consequences of possession of an Insurance Policy is thus stated:

"Possession by an insured of an Insurance Policy is prima facie evidence of its delivery and its verity as a valid and subsisting contract".

Aetna Life Ins. Co. v. Geher
50 Fed. 2nd, 659.

(Citing: *Berliner v. Ins Co.*
53 Pac., 922.)

**(b) The policy was delivered through inadvertence
and mistake.**

We need not point out to the Court that:

(a) Mistake like fraud or any other issuable fact must be pleaded, and the pleading must point out clearly and with precision wherein there was a mistake; and

(b) That such mistake was mutual and did not arise from the negligence of the party relying upon the mistake for relief on account thereof.

Appellant seeks to be relieved of the consequence of Mr. Caskey's delivering the Insurance Policy to the deceased; and in this connection it is pertinent to point out that the burden was upon the Appellant to plead and prove facts that would relieve it from the consequence of its act - - *which act in this case it calls "mistake"*. The mere denomination of an act as a "mistake" does not meet the pleading requirement of detail or certainty - - It is a mere conclusion, and could be the basis of no relief.

Nat'l. Mut. Fire Ins. Co. vs. Sprague
92 Pac., 227

Eucalyptus Growers vs. Orange County Nursery
163 Pac. 45

State vs. Minn. Land Impr. Co.
50 Pac. 420

Hughey vs. Smith
133 Pac. 68

In the instant case the Appellant neither pleaded nor proved any state of facts approximating what is known at law as a mistake - or any other state of facts that could be the basis of any relief.

On the trial of this case it is true, and in presenting this proposition for the consideration of the Court, there was and is a veiled intimation - - a sort of subtle suggestion, ostensibly based on some testimony of Mr. Caskey, that some unnamed and unsubpoened "typist" in some manner - - perhaps because of defective eye-sight, (might, mind you!) have sent Rogers' policy contrary to the instructions of Mr. Caskey, her superior. Nothing could be further from the facts.

We quote from the transcript (Tr. 120):

Mr. Ross: "When this policy (Rogers') was received from the New York Office, what was done with it?"

The Witness: "It was entered in this register, those large sheets, the details of it, the policy number and the premium and then the date it was forwarded to the agent in this particular case. The insured or applicant is also put in the register and then a record of it is made on a card, certain details of it, and then it is sent to the agent and with it is a, what you may call an invoice form giving him certain instructions on there as to what to do or what not to do, requirements and different things of that sort. That is all there is to handling policies in a branch office." (Tr. 79-80)

Q. What is your position:

A. Cashier.

Q. And were you the Cashier of the company on December 29th? A. Yes, sir.

Q. On December 29th, 1939? A. Yes, sir.

Q. And as such, did you have charge of the policies of the life insurance company, the defendant in this case?

A. Well, yes, I suppose what you mean, did I have charge of sending the policies out?

Q. Yes? A. I did.

Q. And you have examined this policy?

A. Today?

Q. Yes? A. Yes, sir.

Q. And this is the policy issued on the life of Zeno A. Rogers? A. Yes, sir.

Q. And did you mail this policy to Mr. Zeno A. Rogers?

A. Well, it was mailed under my supervision.

Q. It was mailed either by you or by somebody who was working under your supervision?

A. Yes, sir.

Q. Regular mail through the United States Post Office? A. Yes.

Q. Postage prepaid and addressed to him where?

A. Well, as I recall, Willcox.

Q. And is this policy in the same form and condition it was in when you mailed it?

A. As far as I know. I would not think there would be any change in it. It appears all to be there.

We think the conclusion - - in fact the only conclusion that can be drawn from the record, is that Mr. Caskey regularly mailed Mr. Rogers' policy to him at Willcox, Arizona, in the regular course of business without any restrictions, conditions, or requests; and that he intended to do just what he did - - - it was only later that he

began to have other "ideas" about the matter. (App. St. Sec. 8 Par 8)

Mr. Caskey seeks to leave the impression that *he first noted* that Mr. Rogers had possession of his insurance policy when he received Rogers' salesman report some time between the 15th and 23rd of January, 1940, and in this connection, we have a striking illustration of the old adage that "actions speak louder than words". Mr. Caskey states that it is the practice of his Company's Local Office about the 15th of each month to send to the various Company salesmen a certain routine blank on which the Local Office first, in appropriate spaces appearing thereon, enumerates the various policies which have previously been sent to the salesman; the amount of monies sent in by the salesman as shown by the Company records, and requires the salesman to *enter upon the report* the disposition of policies sent and other information requested.

Such a form paper and request, was forwarded by Mr. Caskey from the Local Office to Rogers about January 15, 1940, and thereon *was typewritten* the names of policies previously sent by the Home Office to Mr. Rogers with request for information concerning the same under the appropriate spaces entitled "remarks" (App. St. Sec. 8 Par. 9 ante). As sent forward by Mr. Caskey, *he noted thereon* that *Rogers' own* policy had previously been sent to Rogers and Rogers was asked for "remarks" concerning this policy, the same as any other.

Rogers, in the appropriate spaces, entered - not with the typewriter - but with pen and ink, the information called for by Mr. Caskey's communication; and among other things indicated by his remarks the status of his

own policy. When Caskey says that he first learned Rogers was holding his own (Rogers) policy when he received Rogers' report some time about January 15th, he is mistaken - - His own records and his own communications challenge his statement and establish the fact that he knew perfectly well that Rogers had this policy all the time.

At the time Rogers made this report, he had a number of promissory notes due him for commissions and premiums which would shortly be due, but not yet matured, and which he was holding. He did not, therefore, remit the amount of premiums hoped for by Mr. Caskey, and thereupon Mr. Caskey decided that he might improve the securities position of his Company and hasten collections, by the sending of his letter of January 23rd requesting Rogers to return his policy. He says "so that the Company might hold it until the premium was paid."

It is to be remembered that Caskey's letter of the 23rd (Tr. 129 - Defendant's Ex. E.) could not reach Rogers until about the date of his death, and that he would have no opportunity to suggest the existence of his credit arrangement with Mr. Lindberg, or to comply with any request to pay the initial premium.

The defendant Company was called upon to show that it should be relieved from the consequence of its act, i. e. the delivery of the policy. The record conclusively shows that Mr. Caskey actually intended to, and actually did mail the policy, that he did the very act which the circumstances required and dictated, and that it was his intention to do the very thing accomplished.

In view of the credit arrangement between Messrs. Lindberg, Rogers and Clem, and in view of the compliance

of Rogers with all requirements connected with the issuance of the policy, there was absolutely no reason why the policy should not have been delivered to Rogers.

In no place has the Appellant attempted to show that there was any *mutuality of mistake*; no place was *fraud pleaded* or shown; and no place was it shown that *the deceased in any manner whatsoever contributed to the mistake*.

Such a state of facts furnish no ground on which relief can be granted. 32 C. J. Sec. 44, p. 1271; *Traveler's Ins. Co. v. Jones*, 73 S. W. 978 - 979; *Wheeler v. Holloway*, 276 S. W. 653; *Magnolia Compress Co. v. Dennis*, 19 S. W. 2nd 339; *Grimes v. Sanders*, 32 L. Ed. 798.

It will be remembered that Caskey's letter was wholly a self-serving declaration and unrelated to the negotiations carried on by Lindberg; that the letter only reached Rogers about the date of his death; and that he had no opportunity to dispute or respond thereto. The law applicable to a situation of this kind is thus stated in 19 Am. Juris. p. 78, Sec. 58.

"Ability of Party to Avert Harm - Negligence -

In some circumstances, relief will not be granted upon a showing simply that the complainant, at the time of the disputed transaction, was ignorant of, or mistaken as to, some matter of fact; it must be made to appear that his ignorance was excusable. The conclusion is that he is not entitled to relief where the evidence shows that he was 'negligent' or that he could and would have ascertained the facts by the exercise of 'due' or 'reasonable' diligence, or where he had 'means of knowledge' or 'might have ascertained the truth'. In other words, mistake,

to constitute equitable relief, must not be merely the result of inattention, personal negligence, or misconduct on the part of the party applying for relief. The issue as to whether the complainant did or did not exercise the requisite activity or diligence is to be determined, of course, with reference to the facts and circumstances which attended the transaction. Where the complainant's mistake or ignorance of facts has brought about a legal situation which must result in loss or prejudice to one of the parties to the transaction, relief will be denied if the evidence shows that they were equally well situated to be informed as to the facts."

We submit therefor that Appellant can claim no right to relief because of the action or lack of action of Caskey—the question is not what Caskey did, but what was the agreement between Lindberg and Rogers? No facts or circumstances constituting mistake which equity could relieve occurred in this case.

(c) The policy was sent to him in his representative capacity.

Appellant's suggestion in this regard constitutes *an obvious departure*, and the attempted introduction of a defense never mentioned heretofore. We observe under the preceding corollary ((b) ante), counsel argue and maintain, that it was not the intention of the Company to send Rogers his policy at all, or in any capacity; now counsel abandon the assertion of mistake and say in effect - "there was no mistake; we intended to send Rogers the policy but Mr. Rogers has a 'split peronality, a dual status', and we sent it to him in his capacity as agent."

In connection with the argument under this subdivision of Issue No. II, they quote from the case of *Urseth*

vs. Sun Life Assurance Company of Canada, (C. C. A. 8th, 1941, 119 Fed. (2d), 529. The lack of parallelism of the foregoing case, with the instant case is plainly apparent from a reading of the facts on which the decision was based. In that case when the policy was sent to the agent it was accompanied by a memorandum notifying him he "could not release the policy until the initial premium was paid".

Of course, in the instant case no such notice or memorandum accompanied Rogers' policy when received by *him*, or at any other time. The case we submit is in no wise in point.

Furthermore, counsel's statement that "the policy in the instant case was forwarded to Rogers along with other policies which was sent to him as Appellant's agent" is not correct. There is not one scintilla of evidence in the record to that effect.

There is a suggestion that policies are sent from the local office to the agent, and that more than one might be sent at one time, but by the ruling of the Trial Court in this case, Mr. Caskey, who was testifying about this matter, was limited in his testimony to what was done respecting the delivery of Rogers' policy - not as a general practice and not what was done in other cases. Nowhere does it appear that any other policy was at the time sent to Mr. Rogers with his own.

We think this proposition is patently without merit.

Even had there occurred any circumstances which might be the foundation for a Plea of Mistake, the Defendant herein does not come into Court with Clean Hands, and under the familiar Maxim

it would be entitled to no equitable relief with respect to the insurance policy.

We submit that the circumstances attending the delivery of the Insurance Policy in this case, could in no wise furnish the basis for the defense of alleged mistake, but even were there such basis, the defendant "does not come into Court with clean hands" and is not qualified to set up such an equitable defense.

The record herein, shows, that upon the death of Rogers, and while his widow, the plaintiff, was making preparations for bringing her husband's body to Phoenix for burial; and after Mr. Lindberg had asked permission to enter Rogers' hotel room at Willcox, and the widow had requested him not to do so, and had emphatically forbidden him to do so, Mr. Lindberg, the defendant company's Agency Director and Chief Representative, in complete disregard of fair dealing, equity and common decency, forcibly entered the private room of Rogers, and took therefrom the personal effects and property of the deceased, (App. St. of Facts, Sec. 10, Pars. (a) & (b)).

It is apparent, that when Messrs. Lindberg and Caskey learned of Rogers' death, their frantic purpose was to defeat a collection under the policy, by any means. Rogers was dead - his lips were sealed - To their minds, the only threat to their design and purpose, were the records and papers which were located in Rogers' Willcox hotel room; and their first thought was to grab these - by guile if possible, by force and stealth, if necessary.

Rogers' effects, including his personal papers and the Insurance Policy involved, belonged to his personal rep-

representatives and beneficiaries - subject to administration by the courts of the State of Arizona.

The Arizona courts were open to the defendant; and if the company had any rights with respect to the property contained in Rogers' room, it could have gone into the courts in the regular and prescribed manner, and there asserted its rights and obtained its proper remedies. The company did not do this. It took the law into its own hands and sought to improve its position with respect to responsibility under the policy, by its own wrong doing, and by this wrongful conduct, it forfeited any equitable right it could by any possibility have, with respect to possession of the stolen policy.

It is unnecessary to cite authorities with respect to this ancient maxim of equity. The examples of the application of the rule are legion, and unconscionable conduct such as that of the company's representatives in this case invokes the severest criticism of the courts. (21 C. J. Par. 165,) and cases cited hereunder.

ISSUE III

In the interest of brevity, and with apologies to counsel, we will undertake to outline what we consider the decisive factual and legal features arising under this issue, viz:

The import of Appellant's argument, hereunder, is to the effect: "That Rogers, previous to his death, did not pay in cash, his initial policy premium of \$40.50, and therefore, his policy never became effective."

In connection with their argument, they make certain assertions with respect to the law and the facts of the case, which may well be eliminated, because they are eith-

er obvious, or have no bearing on the ultimate question -- For instance counsel say in substance:

(a) An agent's act beyond the scope of his authority, does not bind his principal.

(b) One having knowledge of the limitations of an agent's authority, is bound by such limitations.

We may well concede these obvious legal propositions and the authorities cited in support. These, it will be shown presently, are not important to a consideration of this issue.

With respect to the facts, counsel, in substance, say:

(a) That the pamphlet entitled "Instructions to Agents" and the application for the policy, state on their face, that the insurance involved, does not become effective until the first premium has been paid, or is received by the Company, or is in the hands of the agent.

To avoid prolixity, we will admit the contents of these statements in substance, but not their alleged legal effect.

This Issue, it seems to us, is resolved by the following appertaining points or authorities which logically arrange themselves in a related sequence.

1. The statements of the Company's Agents' Pamphlet, Policy and Applications, are to be construed in the light of its customs and practices, with respect to their subject matter - The actual practice followed.

Equity looks to the substance of things, rather than to their form; and it disregards matters of form and technical nicety. It is interested in the substance of things

and not their shadow, and deals with human affairs upon that principle - penetrating beyond the cover in examining the essence of things,

Hitchman Coal & Coke Co. v. Mitchell
245 U. S. 29; 38 Sup. Ct. Rep. 65;
62 L. Ed. 260

Jones v. New York Guarantee & I. Co.
101 U. S. 622; 25 L. Ed. 1030.

Gay vs. Parpart,
106 U. S. 679; 1 Sup. Ct. Rep. 456,
27 L. Ed. 256

as was stated by the California Supreme Court in *Vance v. Anderson*, 113 Calif., 532, 45 Pac. 816:

“Equity looks beyond the mere form in which the transaction is clothed, and shapes its relief in such way as to carry out the true intent of the parties to the agreement, and to this end all the facts and circumstances of the transaction, the conduct of the parties thereto, and their declarations against their own interests, their relations to one another and to the subject matter, are subjects for consideration”.

Now when one of the parties to the transaction involved, has passed away, and important transactions have eventuated, the Appellant Company may not to the prejudice of others, point to these technical statements and in effect say:

“It makes no difference what we have done or said, or how our conduct may have influenced others - Here is what our papers say. We elect to be judged only according to their technicality”.

That is the ultimate import of counsel's argument.

The question is not - just what does the Company's papers say - but how does it do business?

2. There is nothing inconsistent between the statements in the policy, application and agents' booklet of instructions concerning authority of agents' in conflict with our theory of this case. These so-called restrictive statements must be measured by the construction placed thereon by the parties in actual business operations. In most circumstances they apply only to local soliciting field agents, and not to the general manager or Agency Director of the local or Arizona Branch Office.

We shall presently point out to the Court the facts and law arising therefrom—including the functioning of the business plan under which the Company operated, and show how these completely sustain the plaintiff and Appellee; but since counsel have sought to place a purely technical and extremely restrictive and impractical construction, on these various terms and statements, we will undertake to point out generally, how these are regarded by the courts in dealing with insurance matters.

The book of instructions to agents which is referred to by appellant is not shown to be a book purporting to indicate or show limits to, or circumscribe the authority of general agents or company managers or Agency Directors. Mr. Lindberg was and is the Agency Director or Manager of the Branch Office of the New York Life Ins. Company for the entire State of Arizona. As such Director, he is not to be ranked in the category of special or *soliciting agents*. Mr. Lindberg is the alter ego, the plenipotentiary, the factotum of the Company for the State of Arizona.

While the book of instructions declares that policies may not be delivered except for pre-payment in cash, the record shows that it is the accepted practice of the company to oftentimes deliver policies without actual pre-payment of cash, viz. by the acceptance of Notes payable to the agents, either as full payment or down payment on the initial premium, and the policy then being delivered without pre-payment in cash to the insured.

The policy application to which reference is made by appellant in indicating limitations on agents, refers to *soliciting* agents, and in no manner does it refer to the authority of the plenipotentiary or general manager of the defendant.

Limitations upon Mr. Lindberg's authority are not necessarily deemed to be conclusive upon the insured, and may be considered to have been impliedly waived by the agent's ostensible or apparent authority.

Hence the record itself established both the delivery of the policy without pre-payment in cash, and extension of credit, all of which is shown as the usual course and practice of appellant in its business notwithstanding the written instructions to agents in the aforesaid booklet and policy applications.

That the word "agent", in an application and policy, does not comprehend "General Agents", See: *Hartford Life Ins. Co. vs. Hayden's Admr's.*, 90 Ken. 39, 13 S. W. 585, where the Court declared:

"The term 'Agent' in an application and policy of insurance providing that agents are not authorized to vary the terms of the policy, or to receive dues, does not apply to general agents".

So also to the same effect are: *New Eng. Mut. Life Ins. Co. vs. Springgate*, 113 S. W. 824; *Kentucky Home Life Ins. Co. vs. Johnson*, 93 S. W. 863.

We assert then, that the record, supports our contention that Mr. Lindberg as the plenipotentiary of the company, acting as its chief representative, within the State of Arizona, did have apparent or actual authority to effect the credit arrangement, providing for the payment of premiums out of Rogers' commissions. (App. St. Secs. 4; 6, Pars. (a)-(d) Tr. 92, 98; 171-182; 185, 186).

In this connection, re, credit, appellants assert that the only testimony in the record relative to premium payment was appellee's statement that Mr. Lindberg told her of the credit arrangement. This is not correct. Her testimony is corroborated by Gale A. Rogers, her son, who was a witness to remarks made by Mr. Lindberg to Mrs. Rogers, (Tr. 189-190) and such matter of credit arrangement was further substantiated by the testimony of Mr. Clem, (Tr. 181-182), as well as by legitimate inferences to be drawn from the entire transaction.

Mr. Rogers had no notice of any limitations or restrictions upon Mr. Lindberg's authority as the manager or *Agency Director*. The book of instructions referred to, applied to *soliciting* Agents. It is assumed such books of instructions were given to soliciting or local agents. There is nothing about the book or anything in the record to show that the instructions in such document related to or pertained to the duties and authority of Mr. Lindberg. Consequently even granting that Rogers had such book of instructions, nothing therein would give Mr. Rogers any notice of any limitation on Mr. Lindberg's authority as Director of the Company's Arizona business.

The application, fairly construed, related to limitations on the authority of *soliciting* agents. Therefore, it cannot be argued that Rogers, as the assured, had any notice or knowledge of limits to Mr. Lindberg's authority. Lindberg, to him, was the general manager of the defendant's business in Arizona. He was not to Rogers, the soliciting agent. (*Capital Livestock Ins. Co. vs. Campion*, 204 Pac. 604).

Because the factual situations are strikingly similar to that of the instant case, we particularly invite the attention of the Court to *Union Life Ins. Co. vs. Haman*, 74 N. W. 1090; and *Snyder vs. Nederland Life Ins. Co.*, 202 Pa. 161, 51 A. 744.

In *Union Life Insurance Company vs. Haman*, the insured, Drewlow, by name, had acted as assistant to a soliciting agent of the defendant company. Drewlow had in his possession an insurance policy which, among other things, he used as a "decoy policy" as an agent. The company denied liability, on the ground that Drewlow made no application in good faith; never intended to take the insurance and paid no premium thereon.

There was evidence to show that the matter of Drewlow having the policy was discussed by Drewlow and the general manager, in the presence of a Mr. Chapman, another agent and friend of Drewlow. During the discussion, the general manager said to Drewlow, that "he could take the policy and pay for it out of premiums he would make from the business". At this point Chapman was called out of the office. The general manager and Drewlow were left alone. Later Chapman returned to the manager's office and in the absence of Drewlow, the manager told Chapman: - - - "Drewlow had concluded to take the policy." Under this state of facts the

Court found that the general manager could waive a pre-payment of the initial premium, for he had acted with apparent power within the scope of his authority.

In *Snyder vs. Nederland Life Ins. Co.* (*supra*) the action was on a policy on which the premium admittedly had not been paid. The insured was a local agent of the company. The policy was delivered to him under an agreement that the commissions he should earn should be applied by the company to the premium payment. The insured died a few weeks later, but before he had earned any commissions. The agreement as to the delivery of the policy and the manner in which the premium was to be paid was made with the knowledge and consent of the general agent. The Court declared that: "The company could waive the stipulation made solely for its protection, * * * and its general agent could bind it in this regard; * * *".

3. Notwithstanding any Application, Policy or Agents' Pamphlets, and notwithstanding any statements to the contrary, the Appellant has an established, and does a substantial part of its insurance business under a credit system; and makes and delivers its policies on a credit basis.

From an examination of the record and the scope of the Company's business, it is a fair estimate to say that a preponderance of the Company's business is done on such credit basis.

To profess that because of any statements contained in its Applications, Policies or Agents' Instructions, the Company does not do business on a credit basis, is a glaring instance of intellectual dishonesty. The Company's method is subtle and elusive it is true. Nevertheless, it is on a credit basis that it does a substantial,

if not the major portion of its insurance business, (App. St. of Facts, Sec. 2, Par., (b) & (c)).

The explanation of the system by its local representative, Mr. Caskey, is disingenuous, but nevertheless, effectively establishes the actual operation of such a credit system. Here is his testimony: (Tr. 142-144, 156).

“Mr. Dougherty: Now, Mr. Caskey, do you say that in all cases where policies of this nature, similar policies are issued on the lives of the insured, that the premium, the first premium must be paid in advance before the policy is delivered?”

The Witness: You mean on the life of an agent?

Q. No, I am speaking of -

A. No.

Q. Do you deliver policies on credit?

A. No, sir.

Q. Well, how do you get around it? You don't get cash always, do you?

A. No, the agent is responsible to us.

Q. Well, your company does?

A. No, we deliver to the agent.

Q. Yes, without the pre-payment of the premium?

A. That is right.

Q. And who do you look to for payment?

A. The Agent.

Q. So that you deliver that policy then on the credit of the agent?

A. No, we deliver to the agent.

Q. And who do you look to for payment?

A. The Agent.

Q. The agent? A. Yes.

Q. Now, that is extending credit to the agent, isn't it? A. No.

Q. No?

A. No, it is not. We hold his credits for those premiums.

Q. Yes, so you look to him for payment?

A. That is right.

Q. And there was nothing about the delivery of this policy that distinguished it from the delivery of any other policy to any other agent?

A. Well, what do you mean by that? Put it a little more clearly there.

Q. Yes. You didn't get - what you are telling this jury is, you didn't get cash before this policy was delivered?

A. That is right.

Q. Now, in your ordinary practice of your business, business practice rather—

A. Yes.

Q. Do you deliver policies without having received a pre-payment of the premium?

A. Well, I don't - -

Q. Your company does?

A. No, the agent may.

Q. How the policy finally reaches the insured I am not concerned about, but the result of the methods you employ is, that a policy is delivered to the insured in many cases without the pre-payment in cash of the premium, isn't that true?

A. Oh, yes, the agent delivers them to the applicant without pre-payment of cash.

Q. When an agent delivers the policy to an applicant and receives cash, does he give the applicant any form of receipt for the policy?

A. Well, he is not required to because the policy it-

self is a receipt for the payment for the first premium. There is no necessity for giving the receipt.

Q. The policy itself is a receipt for payment of the first premium. A. It states it is."

Now, if this witness' testimony means anything it establishes as facts that:

1. The company issues and delivers its policies on a credit basis.
2. The company does deliver policies without the payment of the initial premium in cash.
3. The delivery of the policy is regarded as a receipt for the payment of the initial premium.
4. On delivery, the effective date is by relation, established as the date fixed in the policy.

The Appellant's credit system was the subject of discussion in the case of *New York Life Insurance Company vs. Silverstein*, 53 Fed. (2d), 986, and our conclusions as above stated are there sustained.

The Seeming Contradiction

Rogers' application and policy are made part of one instrument and are to be construed together. The provisions of the application and policy which are of materiality in this case are in substance as follows:

The Application (Plt's. Ex. No. 3, Tr. 92-95)

- (1) Only enumerated officers can make, modify or discharge the policy or waive any company requirements.
- (2) Acceptance of a policy by the assured is an acceptance of all waivers and conditions.

- (3) The insurance goes into effect as of the date of execution when:
 - (a) The policy is delivered to and accepted by the applicant.
 - (b) The first premium is paid thereon.

The Policy (Plt's. Ex. No. 3, Tr. 86-89)

- (1) The policy and application constitute the entire contract.
- (2) No agent has authority to modify the contract or extend the time for payment of premium.
- (3) The policy is dated December 19, 1940.
- (4) The date of execution is the anniversary date of the policy from which dues are computed if the policy is accepted.
- (5) The policy is made in consideration of the application and the pre-payment of the initial premium of \$40.50.
- (6) The first premium of \$40.50 must be paid in advance and maintains the policy for a period of six months.
- (7) The policy constitutes, and in the hands of assured is a receipt for the payment of the first premium.

The construction which counsel for Appellant seek to place upon the transactions between the Insurance Company and Rogers, is that the company's business plan under which its policies become operative should be disregarded; and that the applications and the policies should be interpreted and construed entirely by the technical provisions thereof.

We differ with them, because we say that the surround-

ing circumstances should be looked to; that the construction placed thereon by the parties, must be considered; and that for this reason, the operating plan should be regarded as of importance in construing the contract; that there is no contradiction and no inconsistency between the interpolation of the credit plan for which we here contend—and which the company follows, and the written provisions of the policy; and that under our construction, both the written provisions and the business plan followed by the company, are entirely consistent and both are given effect. 6 Ruling Case Law, Sec. 239, page 849; Sec. 241, page 852; *Miller v. Brooklyn Life Ins. Co.*, 12 Wall., 285, 20 L. Ed., 398; *Buckley v. Citizens Ins. Co.*, 188 N. Y. 399, 81 N. E. 165, 13 L. R. A., (N. S.), 889; *Lawrence v. Penn. Mut. L. Ins. Co.*, 36 So., 398; *McAllister v. New England Mut. L. Ins. Co.*, 101 Mass., 558, 3 Am. Rep., 494.

Appellants counsel say in substance, “there is no credit plan. The policy does not take effect until the assured pays the first premium in cash during his lifetime”. We say - and Mr. Caskey for the company sustains us, that there is a credit plan under which policies are delivered to the assured; that such policies when accepted by the assured, immediately go into effect as of the date of issuance; and that the provision regarding pre-payment of the initial premium, is *constructively met* by the delivery and acceptance of the policy—which in itself and by its own language, is an acknowledgment of the receipt by the company, of payment of the initial premium; and the company thereupon, looks to its agent for the *actual payment* of such initial premium.

The transaction whereby the insured agrees to pay the soliciting agent the premium on the policy delivered to

him, and the transaction whereby the agent agrees that the Company may pay itself out of any funds standing to his credit on the Company's books, may be regarded as separate and independent contracts which do no violence to, and do not come within any restriction found in any provision of the Company's application, policy or agents' instructions. It follows, therefore, that the Company's operating plan as we have shown it to exist, and the provisions of its documents are not inconsistent and both may be effective without violence to either. The Company admits the plan which we have outlined (See Mr. Caskey's testimony), and we find difficulty in reconciling counsel's restrictive argument with the admission of their client.

4. The credit system applies to direct transactions between the company and Rogers as well as where third parties are involved—in both cases credit is extended to the soliciting agent to whom the Company looks for payment.

Mr. Caskey exhibited a remarkable dexterity in avoidance of questions of the slightest legal color which might be embarrassing to his employer, but had no hesitation in giving a legal opinion, however involved, where it might be helpful to his Company. He also showed commendable industry and ingenuity in attempting to support his oral testimony, by the production of some "paper" where his purpose might be served. His legal acumen was put to a severe test when he attempted to distinguish "debt" from "debt" - - To show that when policies for third parties were delivered to the soliciting salesman, the latter became indebted to the Company and the consequences was a "debt", but if the Company delivered a personal policy to the salesman on credit, the "debt" was not a "debt". He was unable to find any convenient

"paper" to sustain his position, and finally arrived at a distinction without a difference.

Defendant's Exhibit "F",—"Instructions to Agents" provides in part (Tr. 134, 137), that the Company will not accept a note for the first premium; that if an agent takes a note he does so at his own risk, and is personally responsible for the same.

With respect to these notes, Mr. Caskey further testified as follows, (Tr. 159, 161):

Q. Now, Mr. Caskey, your agents usually are used to collect notes received in payment for the premiums, are they not?

A. Well, we don't use them to collect notes, because we have nothing to do with the notes. The notes are theirs and payable to them. They can't be paid to the New York Life.

Q. They cannot?

A. We do not accept any notes.

Q. You look to the agent?

A. The agent looks to himself. We don't look to the agents at all.

Q. Now, on those premiums you say have been collected. Were any of the premiums represented by notes?

A. I imagine so. Some of those were collected?

Q. Yes? A. Oh, yes, I imagine so.

Q. Then you do collect notes for premiums?

A. Yes, sir: because the man was dead.

Q. As a matter of fact, agents frequently turn in notes and you collect it, don't you? (160).

A. Oh, no.

Q. You never collected it?

A. No, sir; just the opposite. We have nothing to do with it."

* * * * *

"Q. In other words, after Mr. Rogers passed away it was purely a matter, a voluntary matter with the policyholders whether they paid it or not?

A. That is right.

Q. You made no effort to make any collections?

A. Yes, we just told you we did.

Q. On these notes? A. Yes.

A. On the notes? A. Yes."

* * * * *

"Q. So had Mr. Rogers lived, he would have - - it would have been his privilege and duty to have collected them?

A. And his duty to collect them, yes, sir. We had nothing to do with them."

* * * * *

It will be observed from the testimony of this witness and the remaining record in this case, that promissory notes from the insured to the agents were entirely a matter of arrangement between the soliciting agent and the insured; that such notes are the personal property of the soliciting agent, and the collection of these notes is entirely a matter of his concern.

The obvious reason for the working out of this plan is that, were the Company to accept these notes in payment of first premium, the soliciting agent would be entitled at that time to payment of commission on the policy sale - To avoid this, the Company charges the soliciting agent's account with the first premium due on the policy when the policy is delivered to the agent, the premium matter is considered closed and it credits him to the extent of any re-

mission when he sends in money from note collections or other sources.

While the Company's pamphlet entitled "Notice to Agents" provides that the Company will accept cash only in payment of his first premium, this provision is met by the plan whereby the agent is responsible for this first premium, and the Company indulges the constructive acknowledgment, that he has, or will have, in his account with the Company sufficient cash credit to pay this premium—His liability is a new and independent debt.

In the first place the soliciting agent is used in the chain of delivery - he receives the policy from the Company and delivers it to the insured.. After the policy has passed out of his hands and into the hands of the insured, the latter has an effective policy; and the Company looks to the agent for payment of the premium at some unfixed future time - it being presumed that the agent will ultimately have in his account with the Company sufficient money to pay this premium.

Where credit is extended to the agent for his personal policy, the Company similarly looks to the agent for payment of the premium. In both transactions the policies pass out of the hands of the Company and into the hands of the insured. In both, the Company looks to the agent for payment of the first premium; and in both, the policies go into effect on delivery.

The time at which the Company actually receives its initial premium may depend upon the diligence and industry of the agent, but time is not the essence of the contract of payment, since it is fixed for convenience only on the happening of a future event, and where the fu-

ture event does not happen, a reasonable time is implied.

New York Life Ins. Co. v. Silverstein, supra

Crooker v. Holmes,

65 Me., 195, 20 Am. Rep. 687

Nunez v. Dautel

19 Wall., 560

22 L. Ed. 161.

5. There was an agreement between the Company, acting by Mr. Lindberg, Agency Director, that Z. A. Rogers should, or might, pay the initial premium upon the policy for which he applied, out of his future earnings.

We respectfully invite the Court's attention to Appellee's Statement of the Case, (Sec. 4, Par. (b); Sec. 6, Pars. (a) & (b); Sec. 11, Pars. (a) to (c) inc.)

These abstracts, amply supported by the transcript, show definitely from the evidence of Mr. Clem, Mrs. Rogers, Gale Rogers, Mr. Lindberg and Mr. Caskey's letter of December 23, 1940, that a credit arrangement for the payment of the initial premium on Z. A. Rogers' policy had been definitely made and was in full force and effect at the time of his death. We mention this only because, in their argument, counsel suggest (p. 30), a conflict of proof on this point.

It is unnecessary to re-examine this question of fact, because the jury's verdict resolved this fact, as all others, against Appellant and in favor of Appellee. It is true that on the trial this statement is argumentatively challenged by the Appellant, but nevertheless, there is a preponderance of the evidence in the record supporting Appellee's contention, and as we conceive the rule to be upon appeal

from the verdict and judgment, no inquiry will be made respecting the preponderance of the evidence.

“The Trial Court’s findings on questions of fact on conflicting evidence, are binding on the Appellate Court”.

Actna Life Insurance Company v. Geher
50 Fed. (2d) 657.

“If there be any evidence in support of the verdict the action of the Court will and must be affirmed.” *Hayne New Trial on Appeal*, Rev’ed Issue, Vol. 2, Sec. 288, Page 1622; *Heinlen vs. Heilbron*, 97 Calif., 101, 31 Pac., 838. In further extenuation of our observations, with reference to this proposition, we advert to the matter only because there is a tendency exhibited throughout the Brief to again argue the facts of the case, which we consider settled by the jury’s verdict.

6. Mr. Lindberg had actual or apparent authority to enter into the agreement with Rogers and Clem.

We have shown (supra this Issue) the identity of credit arrangements with respect to Rogers’ personal credit arrangements and transactions involving third parties. We there show that while in one instance a third party, and a note or other evidence of indebtedness to the agent might be involved, these minutia did not change the proposition that credit in effect, is extended to an agent, and the presumption is indulged that he will make payment out of his commission account, or from other funds.

In view of counsel’s argument that there is no such thing as a credit plan in the Company’s method of operation because of restrictive provisions in the Company’s documents, there is an implied argument that the cred-

it arrangement between Lindberg, Rogers and Clem could not be made. We think we have amply shown that credit arrangements could legally be, and actually were made. Furthermore, these so-called restrictions in no wise precluded the Rogers' credit arrangement, as the authorities show, and do not as we will point out hereunder, sustain the narrow construction for which counsel contend.

The United States Supreme Court has determined that acts of the agent beyond restrictions or limitations of his power shown in the policy may be warranted by a course of conduct or business. In *Knickerbocker Life Ins. Co. vs. Norton*, 96 U. S. 234, 24 L. ed. 689, the Court said:

“A declaration in a policy that the Insurer's Agents had no power to make agreements or waive forfeiture, is only a notice to the assured, which the insured could waive and disregard at pleasure. * * * whether such Company had or had not authorized its agents to make extensions and whether an extension was made in a case; are questions for the jury.”

To the same effect as the above decisions are: (*Schwartz vs. Northern Life Insurance Company*, 25 Fed. (2d) 555; *Certiorari denied*, 73 L. ed. 547; *Ollich vs. New York Life Insurance Co.*, 42 Fed. (2d) 399; *McConnell vs. Southern States Life Ins. Co.*, 31 Fed. (2d) 715; *Metropolitan Life Ins. Co. vs. Williamson*, 174 Fed. 116.

And *Vance On Insurance*, p. 178, is authority for the further proposition, that:

“An absolute delivery of a policy by such agent without payment of the premium, under such circumstances as will justify an inference that

credit is given will constitute a waiver of the condition of a pre-payment”.

The proposition that a general agent, may extend the time for premium payments, and certainly Mr. Lindberg's authority was at least that of a general agent, is conceded by authorities, as indicated by *Couch On Ins.*, Vol. 3, Sec. 633, pp. 2028-2029;

“So, a general agent may extend the time for payment of premiums, * * * and the time for payment may be extended, (by) a superintendent of the insurer, * * * again, an extension of time may arise as the result of a custom or course of dealing on the part of the company or its authorized agent; likewise by the agent's acts and declarations by which insured is induced to believe that time is, or will be, extended as in former instances, etc. * * * *”.

That general agents of the insurer may effect waivers is also supported in somewhat similar language by Sec. 821, Vol. 29, *Am. Jur.*

Couch, Vol. 2, Sec. 514, supports the proposition, that the insured has the right to deal with the agent upon the faith of apparent authority, where the agent's limitations are unknown to the insured.

“One dealing with an Insurance Agent, and having no notice of any limitation on his powers, has the right to deal with him upon the faith of his ostensible powers, whether his agency is general or special. So, a person may bind an insurance company by his acts as general agent, where he is held out as such by the company in the community where he does business, provided limitations on his powers are unknown to those dealing with such agent”.

So also to the same general effect are: *Capital Live-stock Ins. Co. vs. Campion*, 204 Pac. 604; *Van Werden vs. Eq. Life Assurance Soc.*, 68 N. W. 892. In the latter case the Court observed:

“Where a foreign Life Insurance Society maintains a branch office in a State, with a Manager whose agency is general in that State and to whom the people look for information or adjustments of the Society’s business in the State, the acts and knowledge of the Manager are the acts and knowledge of the Society”.

An agent with general power, or clothed with actual or apparent authority may waive restrictions, or by his acts and conduct, waive written conditions of the policy, notwithstanding such restrictions. This concept is based upon the theory that such restrictions are ineffectual to limit the legal capacity of the company to bind itself by waiving conditions of the policy through an agent, acting within the real or apparent scope of his authority, and whose knowledge in such case is imputed to the principal.

Provisions in insurance policies restricting the authority of agents are not literally enforced by the Courts regardless of circumstances; *Public Savings Ins. Co. vs. Manning*, 111 N. E. 945; citing *Richardson vs. Brotherhood, L. F. E. Soc.*, 126 Pac. 82, 41 L. R. A. (N. S.) 320.

Likewise it has been declared that provisions limiting the power of agents to waive policy terms except in writing; do not apply where waiver may be implied from the conduct of the agent, *Mishiloff vs. Amer. Cent. Ins. Co.*, 128 Atl. 33.

Rosebraugh vs. Tigard, 252 Pac. 75, is further author-

ity for the proposition that waiver may be implied from the circumstances surrounding or incident to the transaction.

The Court, in the above case, with respect to the proposition under discussion observed at p. 78.

“An insurer is precluded from asserting a forfeiture for delinquency in payment of a premium, * * * where by its course of dealing or business or its custom or by any course of conduct, known to insured, it has induced an honest belief on his part that prompt payment of the assessment will not be insisted upon, or that payment need not be made until demanded”. 26 C. J. 329; 14 R. C. L. 1183, 1184; *Cranston vs. Westcoast Life Ins. Co.*, 72 Or. 116, 142 Pac. 762; *Hinkson vs. Kansas City Life Ins. Co.*, 93 Or. 473, 183 Pac. 24; *North Amer. Acc. Ins. Co. vs. Whitesides*, 134 Ill. App. 290.

That Mr. Lindberg's power to effect the waiver provisions here contended for may not only be inferred from the attendant circumstances, but that such power might be implied from the designation of his title is sustained by *Whipple vs. Prudential Life Ins. Co.*, 222 N. Y. 39, 118 N. E. 211, where the Court observed:

“The designation of ‘manager’ implies general powers. It could not be held as a matter of law, that he did not possess as General Agent, general powers. That he had control of the business of the Cleveland office permits the reasonable inferences that his acts were presumptively those of the company”.

And, by the case of *Hartwig vs. Aetna Life Ins. Co.*, 158 N. W. 280, where the Court said: “Credit may be

given for the first premium, and, if not expressly given it may be shown to have been given by circumstances characterizing the transaction”.

In view of the citation of authorities, can it be gainsaid that Mr. Rogers was not induced to believe that Mr. Lindberg had apparent authority to effect the credit arrangement, when Mr. Lindberg was already party to the credit arrangement in re, Mr. Clem's \$75.00 expense loan?

It may be noted in passing that the cases cited by Appellant's counsel under this Issue generally have to do with fact situations where the agent involved was a *soliciting* agent. That powers of the soliciting or sub-agents are more closely scrutinized by the Courts, requires no citation of authorities. This distinction, with regard to the fact situations may be observed with reference to all of Appellant's cases cited under this Issue with the exception of *Penn. Mut. Life Ins. Co. vs. Blount*, 33 Ga. App., 642, 127 S. E., 892, and their quotation from such

case does not show the facts on which the Court's decision rested. An examination of the facts will show that it is in no wise a parallel case. In our previous argument under this Issue we have attempted to point out in detail the relationship between the contents of the Appellant's policy and application, and its operating plan (See No. 3 ante).

The Penn. Mutual Life Insurance Company's operating plan, with which the Georgia case dealt, differed from the instant case. In that case the concept of a constructive satisfaction of the requirement for payment of the initial premium was precluded. Under that plan - although

the policy recited that delivery was considered a receipt for, and an acknowledgment of the payment of the initial premium, the Court found under the Company's operating plan that in no event could there be a legal delivery of a policy until the initial premium was actually paid in cash; and if a policy were delivered without such actual payment by the assured, in cash, such delivery would be considered of no force and effect. Such is not the operating plan of the Appellant Company, and for that reason the Georgia decision is not in point.

7. Rogers' policy became effective on delivery, and receipt thereof, and was effective at the time of his death.

The policy in the instant case was applied for on December 7th, 1939, and a rider with reference to aeronautical activities which constituted part of the application was executed by Rogers on December 11th, and thereafter on December 19th, the company at New York issued the policy embracing all the essential elements as set out in the application. Thereafter in due course of mailing, and a few days after December 29, 1939, delivery of the policy was effected without any memoranda or instructions to Rogers. (App. St. Secs. (6), (7) & (8) ante).

In view of the fact that a credit arrangement providing for the extension of time in which to pay the premium had been made between the Agency Director, Rogers and Clem (App. St. Sec. 6, ante), the policy became effective December 19th, 1939, the date of its execution. While there was conflict in the evidence as to the making of such credit arrangement and extension of time for payment, the conflict was resolved in favor of the appellee by the jury.

The policy having been issued and embodying all the essentials as set out in the application, its unconditional delivery without memoranda or instructions to Rogers made it effective on December 19th, 1939, its execution date, though delivered to Rogers about January 1st or 2nd, 1940.

Farnum vs. Phx. Ins. Co.
83 Calif. 246

Aetna Life Ins. Co. vs. Geher
50 Fed. (2d) 659

~ *Berliner vs. Travelers' Ins. Co.*
53 Pac. 922

Bloom vs. Pac. Mut. Life Ins. Co.
259 Pac. 496

Appleman On Ins.
Vol. 1, Sec. 131, p. 121

The credit arrangement having been made and the policy having been delivered in pursuance thereof, the policy was binding and effective on the company, as of the date of delivery, and if binding and effective as of that time, in view of the credit arrangements, as the jury found, then it follows that the policy was in full force and effect at the time of Rogers' death.

8. Rogers had the privilege of paying the first premium on his policy out of his earnings or out of any other funds he might care to use.

Where, as in this case, credit was extended for the initial premium, with the understanding that it would be paid out of future commissions of Rogers, the payment was not conditional to the extent of depending wholly and finally on that method - such a stipulation is regarded as securing the debtor a reasonable amount of

time within which to procure in one mode or another, the means necessary to meet his obligation,

Nuncz v. Dautel,
19 Wall., 560,
22 L. Ed. 161

9. On the death of Z. A. Rogers, his wife and son, and his wife individually, succeeded to the right of the deceased to make payment of the premium within a reasonable time.

Under Par. 978, Chap. 20, RCA, (1928), (Descent and Distribution), Rogers' wife and son succeeded to any interest which the deceased father might have. In addition the wife, named therein as beneficiary, had a further right to make payment as the beneficiary under the policy.

Sargent v. Adams
Mass. 3, Gray, 72, 63 Am. Dec., 718.

The effect of Z. A. Rogers' promise to pay the initial premium was an agreement on his part to pay the same out of his earnings, and this implied that he would have a reasonable time so to do, and would also have the right to make payment from any other funds he might be able to supply, (See our argument under (8) this Issue, supra). His personal representatives would succeed to his rights, and would have a reasonable time in which to make payment in the event Rogers' commissions did not satisfy his debt.

10. Rogers' payment of his initial premium could not become due until demand for payment was made.

"If a contract for payment of money fixes no specific time of payment, it is payable on demand."

Columbia Bank v. Hagner
1 Pet. 455, 7 L. Ed. 219

Grant v. Groshon, c Amer. Dec. 725.
Note, 12 Am. Dec. 575.

By the terms of Rogers' policy, the initial premium amounted to \$40.50, and prepaid the premium for a period of six months - up to and including June 19, 1940, when there would have become due a like sum of \$40.50 as an accruing premium.

At the time of his death, Rogers owed the Company a debt of \$40.50, which might be discharged by payment by means of future commissions within a "reasonable time", or by payment from any of his other funds which he might care to apply on this debt.

In view of the fact that the debt was not payable at a fixed time, it was essential that a demand be made for payment, and in such event he would have a reasonable time to comply with such demand.

21 Ruling Case Law, Sec. 8, Page 15.

11. The Appellant Company gained no rights by Lindberg's wrongful act in entering the room of the deceased, and taking Rogers' policy, notes and effects.

We have heretofore had occasion to refer to Lindberg's conduct with respect to his wrongful entry in discussing Issue 2, (ante) relative to Appellant's request for equitable relief on the ground of mistake. We, are, therefore, suggesting the applicability of the maxim:

"He who comes into Equity must come with clean hands".

It is also an age-old maxim of the law that:

“One party to litigation may not improve his position by his wrongful conduct”.

Another cognate maxim is that:

“He that hath commiteth inequity, shall not have an equity”.

Stated in another way, the Courts have said:

“A Court of equity cannot be successfully invoked to assist parties in taking advantage of their own deliberate wrong and willful misconduct”, (10 RCL, Sec. 139, Page 389).
DeWolf vs. Johnson; 10 Wheat., 367, 6 L. Ed., 343.

As suggested previously, when Rogers died, Messrs. Lindberg and Caskey became concerned about his insurance matter. They knew perfectly well, or should have known that his policy was effective, and immediately sought a means of defeating collection by the widow. There is an old adage concerning possession and its significance, which it is fair to assume, men in their position had probably learned about, and they decided to get possession of this policy, and Rogers' notes and other data at once, and by any means necessary, and to repudiate the policy, and they straight-way acted upon this impulse. Such conduct, we submit, could help them not at all.

12. The appellant could not under the circumstances of this case, repudiate, forfeit or cancel its policy without demand for payment of initial premium upon Rogers' personal representatives, and surrender of the policy, notes and papers which Mr. Lindberg wrongfully took from the room of the deceased, Zeno A. Rogers.

Appellants witnesses were at great pains to point out at the trial of this case, that the promissory notes taken by Rogers, or other agents, in payment of initial premiums, "were the property of these agents and not the company's property." This was emphasized again and again. And the company's right to collection of the notes was emphatically denied.

On the death of Rogers, his personal representatives were entitled to the possession of the insurance policy, and also of all other papers and documents belonging to the deceased, which Mr. Lindberg wrongfully and forcibly took.

What appellant attempted to do—acting in this regard, by its Arizona representatives, was to repudiate, cancel or rescind Rogers' policy theretofore issued; but obviously before this rescission could become effective, it was essential that the appellant perform, at least two acts which they did not perform, viz:

(a) Rogers' insurance policy, together with the promissory notes, and other papers taken from Rogers' room should have been surrendered to his personal representatives.

(b) Rogers' personal representatives and the beneficiary under the policy, should have been afforded a reasonable time within which to make payment of the initial premium.

The appellant took neither of these required steps - - it attempted to take the law into its own hands and repudiate the policy. (App. St. Sec. 11, Pars. (a) to (c) Inc., ante); and this attempted repudiation or rescission, was manifestly premature and of no effect. *McCulloch vs. Scott*, 13 B. Mon. (Ky.) 172, 56 *Am. Dec.* 561 and Note;

Bell vs. Campbell, 123 Miss. 1, 24 S. W. 359, 45 A. S. R. 505.

13. The wrongful seizure of Rogers' policy, notes and effects, and the Company's repudiation of all its obligations, under his policy, relieved Rogers' personal representatives and his policy beneficiary from the necessity of making any tender or offer of performance.

Considering the conduct of the Appellant, a tender of payment or an offer of performance of any kind on the part of Mrs. Rogers, or her son, would manifestly be a useless and futile act. Mr. Lindberg had seized the policy. He had declared that it was of no effect because Rogers had died. He refused to acknowledge the responsibility of his Company in any manner, and clearly informed Mrs. Rogers that the Company would not recognize the policy, and would not pay it under any consideration. The law in such an instance is very clear. - No tender or offer on the part of the personal representatives, was required. *Barney v. Bliss*, 1 D. Chip. (Vt.) 399, 12 Am. Dec., 696; *Adams v. Clark*, 9 Cush. (Mass.) 215, 57 Am. Dec. 41; *Adams Express Co. v. Harris*, 120 (Ind.) 73, 21 N. E. 340, 7 L. R. A. 214; *Cleveland, etc. R. Co. v. Anderson Tool Co.* 180 (Ind.) 453, 103 N. E. 102, 49 L. R. A., (N. S.), 749.

We submit it to be the law that Appellant's denial of the rights of the plaintiff and Appellee herein, before the institution of her suit, rendered the question of burden of proof with respect to payment of initial premium moot and unimportant; but if such misconduct and denial of rights on the part of Appellant did not eliminate the question of payment and its appertaining burden of proof - then we say in this connection, that there are

other good and sufficient reasons relieving the plaintiff and Appellee from the burden of proving payment of the initial premium, which counsel emphasizes with such repetition.

14. (a) Counsel's wrongful seizure and intrusion into Zeno A. Rogers' business affairs shifted any burdens which might have otherwise arisen under the circumstances, from the plaintiff and Appellee to the Appellant.

Where, as in this case, the Appellant took possession of Rogers' property, including his policy, promissory notes and other property, equity raises in respect of such property, a constructive trust; and constitutes the wrongdoer—in this case Mr. Lindberg, a *trustee ex maleficio*, and where as herein, the person so held as a trustee ex maleficio intermeddles with, and assumes to manage, or do anything with respect to the property wrongfully seized, he is held to become also a trustee de son tort. *Arntson v. Sheldon First Nat'l. Bank*, 167 N. W., 760, L. R. A. (1918F), 1038, *Robinson v. Pierce*, 118 (Ala.) 273, 24 So., 984, 72 A. S. R., 160, 45 L. R. A., 66; *Edwards v. Culbertson*, 111 (N. C.) 342, 18 L. R. A., 204; *Bailey v. Bailey*, 67 (Vt.) 494, 32 (Atl.) 470, 48 A. S. R. 826; *Morris v. Joseph*, 1 (W. Va.) 256, 91 Am. Dec. 386; *Garvey v. Jarvis*, 46 (N. Y.) 310, 7 Am. Rep., 335.

It will be remembered that Messrs. Lindberg and Caskey disclaimed all right or interest of the Insurance Company to the promissory notes made to Zeno A. Rogers, and seized by Mr. Lindberg. They also disclaimed any right of the Company to collect the same, and yet, *they did both*. Under the circumstances, it was the duty of the Company, and it carried the burden throughout

the trial, of fully accounting for, and of showing fully just what the Company did in the premises, and just what money was received, and how it was applied. This the Appellant did not do.

Under the circumstances, the utmost good faith was required of the Appellant as trustee ex maleficio, and as trustee de son tort, to show complete performance with utmost skill and energy in performing all the acts and things which, but for their wrongful conduct, Zeno A. Rogers' personal representatives or beneficiary, might have done and accomplished and the proper and equitable application of the moneys collected. The Company did not discharge its duty in this respect—it contented itself with showing that it apparently picked out the "cream" of Rogers' promissory notes, and abandoned and made no further effort to collect the others. It said in effect:

"Well, under the way we handled it, our records don't show that Zeno A. Rogers ended with any credit standing to his name".

The Appellant made no effort whatever, to show what it did towards collecting these notes, or that they were uncollectible, or anything else necessary to discharge it's duty in the premises.

14. (b) If there was any burden upon the plaintiff and appellee under the circumstances of this case, which we deny, to show that there was payment of the initial premium or its equivalent, viz: credit arrangement, this proof was discharged by proving delivery of the policy, premature foreclosure of her rights as personal representative and beneficiary, and this burden, if any existed, then shifted to the defendant to show that the rights of the plaintiff and appellee had not been

denied and that it had performed all trust duties which were imposed on it because of its seizure and meddling with the property of the deceased.

Delivery of the policy and the wrongful taking of it, together with Rogers' promissory notes, were established beyond question; and the circumstances fully admitted by the appellant. For these reasons, we submit the question of burden of proof, with respect to the plaintiff and appellee, is moot and unimportant.

We have previously quoted authorities as to the burden as a consequence of appellant's wrongdoing with respect to the effect of proof of delivery, but in the event such a burden were initially carried by the plaintiff, the Courts state:

"* * * evidence is required to be established whether or not a premium or assessment was paid in accordance with the terms of the policy, or whether a *credit* was *extended* for its *payment*".

33 C. J. Sec. 858, p. 126

Harris vs. Sec. Life Ins. Co.

Ann. Case 1914 C. 648.

The appellee, as the record will show met this burden by showing, the delivery and possession of the policy, and the equivalent of payment, namely that a credit arrangement was effected as between the Agency Director and the insured, and that in pursuance thereof, the policy was duly and unconditionally delivered to the insured.

The legitimate inferences flowing from the possession of the policy are a presumption of payment. Possession of the policy by the insured was *prima facie* evidence of

its delivery and payment as a valid and subsisting contract.

Actna Life Ins. Co. vs. Gcher
50 Fed. (2d) 659

“Where an insurance policy is delivered without requiring payment of the premium the presumption is that a credit was intended and the policy is valid.”

Brooklyn Life Ins. Co. vs. Miller
12 Wall. (U. S.) 285
20 L. ed. 398

Farnum vs. Phx. Ins. Co.
17 Am. St. Rep. 233

Under the facts and circumstances of the case, as we have previously shown, the burden in this case with respect to plaintiff and appellee's rights, and with respect to payment of premium was upon the appellant; and its evidence offered in discharge of this burden was rejected by the jury.

We submit therefore, that the plaintiff and appellee by her evidence fully met all requirements and discharged all burdens of proof incumbent upon her for the maintenance of this action.

SUMMARY

We regret that it has seemed necessary to discuss at some length what has seemed to us to be the decisive law points applicable to the material facts in this case. We will ask opposing counsel to bear some of the censure if our argument seems prolonged. The plan adopted by counsel does not, we think with all due respect to our able opponents, lend itself to a brief answer, and one of the reasons why, is because in the pattern which counsel

have followed we have found difficulty in segregating their argument as to the Appellee's right to maintain this action, and the sufficiency of her proof.

So that they might be answered in their proper relation, we have attempted to segregate questions relating to the plaintiff and Appellee's right to maintain this action, from the essential proofs required on its trial; and in our analysis we think, that we have fully established, and supported by ample authority, that because of the facts and circumstances of the case, there accrued to her, this cause of action, which she instituted, and which we think she has sustained by ample proof, to wit:

1. Rogers held an enforceable contract of insurance with the Appellant at the time of his death.

2. Because of the admitted conduct of the Appellant, there accrued to the plaintiff and Appellee herein, a right to bring this action without the performance of further acts on her part.

The suggestion of counsel's argument under this Issue, viz: That Rogers knew Lindberg could not agree as to extension of credit for first premium; that the Insurance Company was not bound by the action of its Agency Director, and the authorities cited in support of these two propositions, have we think, been fully met, including all "Hornbook Law" concerning the actual methods and customs of doing business.

We believe further that we have shown that if Appellant has not received payment of its first premium, it is because of its high-handed conduct in making such payment impossible. The original and influencing conclusion reached by the Appellant acting in this regard by

its Arizona officials, is strikingly revealed in Lindberg's statement, in substance, to Mrs. Rogers:

"Everything would have been alright and the policy would have been good, had your husband lived but his death ended everything".

In this conclusion we submit that Mr. Lindberg was mistaken—Rights such as Zeno A. Rogers possessed do not die with him, even though he cannot come into Court and speak for himself—the law protects him and those who are justified in looking to him for care and sustenance. Upon this theory, as stated, we submit the right of Mrs. Rogers to maintain this action is fully established.

APPELLANT'S OBJECTION TO INSTRUCTIONS

Before considering separately the issues under this feature of the case, it seems proper to point out that Appellant's objections are cognate parts of its theory of the case, viz:

That regardless of the public's reliance on the actual customs and practices of the Company, and regardless of the fact that it constantly delivered its policies in the regular course of business, which policies, admittedly, became effective on delivery without the pre-payment of the initial premium - yet, no policy of the Company could become effective until the first premium was paid in cash. That it would have been better from a security standpoint, if the Company had held Rogers' policy in its Phoenix Office until the first premium had been paid, and that Mr. Caskey was careless in mailing the policy to Rogers, and that such carelessness was a "mistake" from which it should be relieved. Further, that unless Mrs. Rogers could show there had been an actual payment of the init-

ial premium in cash before the policy was delivered, she was not entitled to recover under any conditions. That the manner and method by which Mr. Lindberg and Mr. Caskey conducted the Company's business in Arizona, and regardless of their actions or conduct in this instance - no matter what else might have been established by the evidence, in no event could the Company be held liable, unless the Appellee showed the payment of the initial premium in cash.

The vice of this theory, as we see it, is that it seeks to completely ignore other facts and circumstances of at least as great importance as this initial premium payment; begs the question in many instances; and rests entirely upon technicalities.

ISSUE IV, V AND VI

Appellant's objection to that part of the Court's instruction which it calls Plaintiff's "Instruction No. 1", (Tr. Par. 1, Page 224) is because it says that the Court in substance told the jury:

That if the Appellant knowingly held Lindberg out to the world as having authority to waive payment of the first premium, and if Rogers believed him to have such authority, the Appellant would be bound by its conduct.

Appellant says this instruction was faulty because there was no evidence that Lindberg was so held out to the public, or that Rogers was thereby misled; that the instruction was prejudicial to the Appellant. How, it does not say.

This objection again begs the question. The Appellant's witness, Mr. Caskey, admitted - and other evidence

showed, that under the administration of the Arizona Office, by Mr. Lindberg and Mr. Caskey, and the regular practices and customs thereof, Insurance Policies were constantly delivered to the insured without the pre-payment of the initial premium, in the regular course of business, and in complete disregard of what counsel asserts were "restrictive provisions" of it's various documents.

Obviously - with abundant evidence in the record in support thereof, it was a legitimate and proper duty of the jury to decide from the facts adduced - Whether the Company had so held out to the general public, its Agency Director Lindberg, as having authority to deliver - under similar circumstances similar policies, without the pre-payment of the initial premium; and whether from such circumstances and observance, Zeno A. Rogers, was justified in believing that the said Lindberg had authority to cause Zeno A. Rogers' policy to be delivered in accordance with the constant practice of the Company, without the pre-payment of the initial premium.

We believe these questions were properly submitted, and that the instruction properly states the law. The questions submitted were properly related to the evidence, and obviously state an elementary principle of law.

Branson Inst. to Juries 182

Forc v. Hitson, 8 S. W. 292

Smith v. Wise, 58 Ill., 141

Haskell v. Starbird, 25 N. E. 14

We have heretofore pointed out, that these so-called "restrictions" were confined in their operation to solici-

iting and not general agents of the Appellant, and to premiums other than the initial premium.

The undisputed evidence is that the Company constantly, in doing a substantial portion of its business, makes a common practice and custom of delivering its policies to the insured without pre-payment of the initial premium; and certainly, the observance of this fact by Rogers, despite any notice he may have had about technical restrictions with respect to other premiums, might well justify his believing that Lindberg had authority to likewise deliver him a policy under a credit arrangement and without the pre-payment of the initial premium.

This question, we submit, was fairly presented to the jury, and that no prejudice was thereby inflicted upon the Appellant.

Appellant's objection to the next instruction of the Court, which it denominates as Plaintiff's Instruction No. 2, (Tr. Par. 2, Page 224), and admits is a correct statement of abstract law, is that there was no evidence that would justify its being given.

This instruction is but a statement, in a different aspect, of the law and facts relating to the authority, or apparent authority, of an agent, and the resulting consequences thereof where innocent third parties are concerned. The record fully justifies the propriety of giving this instruction, and Mr. Caskey's statement concerning the manner in which the Company did business - even if standing alone, furnished a factual foundation for the same.

The facts in the case of *Wells v. Prudential Insurance Company*, 239 (Mich.) 92, 214, N. W. 308, quoted by

the Appellant, and the cases on which the decision in that case was based, are readily distinguishable from the instant case. In that case the policy holder's claims were based upon an alleged parole contract. In the instant case the customs and practices of the Company, and the credit agreement, consistent with these customs and practices, are made the foundation of the Appellee's claims, and justify the question submitted by the instructions.

It is to be borne in mind, that because of the wrongful conduct of the Appellant's Agency Director, the customary burdens of proof were fixed or constant. That but for the wrongful conduct of the Appellant's General Agents, the initial premium on the Rogers policy might well have, or may have been paid in full. Rogers in common with other soliciting agents of the Company, had an established account in the records of the Appellant, through which his dues to the Appellant, might well have been paid in full—had there been no seizure of his property or intrusion on his business—All of these matters and things were before the jury, and all combined, went to make up the record in the case, at the time these instructions were given. To say that the instructions should be fashioned and based only in such manner as to submit isolated, favorable and technical questions to the jury, is not a correct statement of the law. The instruction correctly stated the law.

Branson Inst. to Juries 182

Hanover Nat'l. Bank v. Amer. Dock Co.,
43 N. E. 72, 51 Amer. State Rep., 721.

Ins. Co. v. Norton, 96 U. S., 234

Manufacturers, etc. Co. v. Armstrong,
45 Ill., App., 217.

U. S. Life Ins. Co. v. Lesser,
28 So. Reps., 646.

Under Issue V, considered in connection with Issue IV, counsel say that Instruction No. 3, (Tr. 225, Par. 3,) is objectionable in that it is not clear and does not clearly state the law. Counsel admit that the Appellee's showing that the policy had been delivered to her husband in his lifetime raises a presumption that the initial premium thereon was paid, and admits that it then became the duty of the Appellant to overcome this proof of possession by some other fact or occurrence. But at this point Appellant again envisions what it considers its own evidence only.

Appellant attempted to overcome the proof of possession by certain facts which it concludes constituted a mistake from which the Court would relieve it of the consequences of the delivery which it had made - In no shape, manner or form was there any intimation of any defense that the policy was delivered to Rogers in his character as an agent, rather than as a policy applicant. This suggestion as we have previously shown first appears in counsel's Brief. Appellant stood entirely on what it's showing was in regard to the circumstances under which the policy was delivered, and nothing else. Now, the record also showed facts that would disprove any claim of mistake, - evidence which showed that Rogers' policy was regularly delivered to him with full intention so to do. This matter has heretofore been discussed fully under Appellant's Issue I.

The Court's subsequent instruction, (Tr. 227, Par. 2), told the jury that delivery was a matter of intention, and that if Zeno A. Rogers' policy had been sent to him without any intent on the part of the Appellant to part with its possession, then such delivery would be considered a mistake, and the jury's finding should be for the Ap-

pellant. There are no conflicts in the instructions, and the entire instructions should be construed together. Whatever the Court instructed the jury concerning the effects of a "holding out" must be read in the light of the entire instructions, and it will be observed that the Court instructed the jury clearly and pointedly as to the burden of proof carried by the plaintiff, (Tr. 227, Pars. 3 & 4).

The Court points out with reference to the burden of the Appellant to overcome the presumptions from the prima facie showing, with respect to possession of Rogers' policy, that if the jury believe this policy had been sent by the Appellant to Rogers, by mistake, that the plaintiff could not prevail. That was the only legal reason offered by the Appellant on the trial of this case to overcome the presumption arising from possession of the policy, and certainly, the instruction, plainly and fairly submitted for the consideration of the jury, Appellant's contentions in this regard, and the authorities so hold. (Abbott, Tr. Ev. Vol. 2, 1242). *Page v. Virginia Life Ins. Co.* 42 SE 543; *Rayburn v. Pa. Cas. Co.* 50 SE 762, 107 Am. St. Rep. 548; *Home Ins. Co. v. Gilman et al* 112 Ind. 7; *De Frece v. Nat'l. Life Ins. Co.* 32 NE 556; *Pointer v. Ind Life et al* 30 NE 876; *Michigan Mut. Life Ins. Co. v. Custer* 128 Ind. 255, 46 At. 1005; *Mauch v Merchants etc.* 54 At 952; *Washburn v. Union Cent. Life Ins. Co.* 39 So. Reps. 1011.

Proof Features Under This Issue

We have shown under Propositions 9 and 10, ante, in our argument under this Issue that the rights of Zeno A Rogers' personal representatives—and Mrs. Rogers as beneficiary, could not be foreclosed until they were first

afforded an opportunity, and a reasonable time to pay the initial premium due under the policy.

The proof that this opportunity and this reasonable time had been given to Mrs. Rogers, the Appellee, was under the circumstances of the case, a burden falling upon the Defendant and Appellant and not upon the Plaintiff or the Appellee.

Counsel's suggestion, therefore, with respect to burden of proof, and that the Appellee must fail herein because she did not prove with greater certainty payment of the initial premium, does not, we think, state the law applicable to this case. In the consideration of counsel's charge of the burden of proof, there are other major propositions of law aiding the Appellee, which counsel have overlooked.

ISSUE VI

Under Issue VI, Appellant complains of what it calls Plaintiff's Instruction No. 4, (Tr. 226, Par. 2), because of their objection to a part of a sentence therein.

Rogers' insurance policy, his application and a duplicate of the alleged "Permanent Aviation Clause" were permanently attached together, and introduced in evidence. It is admitted by the Appellant's witnesses that when Rogers accepted the policy he accepted this Permanent Aviation Clause, thus supplementing his express waiver of all insurance on account of aviation accidents.

The evidence also showed that if there was an "original sheet," of the Permanent Aviation Clause a duplicate of which was signed for him by the Company, and attached to his policy—such original was never transmitted from the Home Office to the Local Office, and

that the Local Office did not have such original paper, and never presented or mentioned anything concerning it to Rogers, (App. St. Sec. 6, Pars. (a), (d) & (e); Sec. 7, Pars. (a) & (b).)

Considering the facts of the records there is no doubt that the instruction was properly given, and correctly stated the law.

Bloom v. Pacific Mut. Life Ins. Co.
259 Pac. 496.

Counsel will, no doubt, admit that this case should not be reversed for inconsequential technical errors which they are unable to show resulted in any injury to the appellant. Every legitimate presumption is in favor of the Court below, and it will be presumed that instructions given were justified by the evidence. If the instructions taken as a whole were substantially correct and no misleading of the jury appears, the judgment will not be disturbed. The judgment will not be disturbed because separate instructions do not contain all conditions and limitations which might be affixed thereto. Instructions are to be read and considered as a whole, and the fact that when taken separately, some of them may fail to enunciate in precise terms and with legal accuracy propositions of law, does not necessarily render them erroneous, but it is sufficient if all the instructions taken together give to the jury a fair and understandable notion of the law regarding the point discussed. *People vs. McCaulcy*, 1 Calif., 379; *Columbia Heights Realty Co. vs. Rudolph*, 217 U. S. 547, 30 Sup. Ct. Rep. 581, 54 L. Ed. 877; *People vs. Doyle*, 48 Calif. 85; *Holoway vs. Dunham*, 170 U. S. 615, 18 Sup. Ct. Rep. 784, 42 L. Ed. 1165; *People vs. Turcott*, 65 Calif. 126, 34 Pac. 618; *Gamachae vs. Piquignot*, 16 How. 451, 14 L. Ed. 1012; *People vs. Mc-*

Curdy, 68 Calif. 576, 10 Pac. 207; *Stephenson vs. So. Pac. Co.*, 102 Calif. 143, 34 Pac. 618.

CONCLUSION

Considering the mercenary, highhanded and arbitrary conduct of the Company's chief representatives, as revealed by the record, then for the Appellant to assert that the judgment of the District Court is unjust, smirks of hypocrisy.

There were no written rules or regulations in the local office, or elsewhere, governing the delivery of Rogers' policy. Mr. Caskey attempted to formulate the rules as he went along. His January 15, 1940, request for a report shows that he knew all the time that Rogers held his own policy, and he did not try to get it back by his letter of January 23, 1940, because of any mistake, but because he thought Rogers wasn't making payment quick enough. The suggestion of mistake, was a mere after-thought—Caskey did just what he intended to do, and what the circumstances dictated and required in mailing Rogers' policy. The fact that he afterwards had a better thought, or subsequently changed his mind is immaterial.

To say, as Appellant does, that the record did not disclose a credit arrangement, is to shut one's eyes to the patent facts of this case. The Company delivered some 24 or 25 policies on the credit of Mr. Rogers, and looked to him for payment of the first premiums thereon, and then to say that it could not or did not deliver his own policy on credit, under precisely the same operating plan, is thoroughly disproved by the record.

Mr. Zeno A. Rogers applied for a policy, signed all

necessary applications, invoked the Company's usual credit plan, and received his policy in the regular manner, and as Mr. Lindberg says: "had he lived, everything would have worked out alright", - - but the main reason it did not "work out alright" was because Lindberg forcibly entered Rogers' room, purloined his policies and notes, denied Rogers' personal representatives, any reasonable opportunity to pay the premium, repudiated his company's policy, took the Rogers' notes and applied the proceeds therefrom, as he saw fit, and to the disadvantage of Rogers.

The jury heard all the evidence, judged all the parties, saw them, and surveyed them; considered the whole situation under proper instructions from the Court, and decided that Rogers' dependents should not be deprived of their just dues, and that the Company should be held to its contract in the same manner as it would be responsible under its credit arrangement, or plan of operating, for a policy delivered to any other assured.

Respectfully submitted,

DOUGHERTY and CHANDLER,

M. J. Dougherty

John Francis Connor

No. 9892

7

IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

APPELLANT'S REPLY BRIEF

ELLINWOOD & ROSS,
JOS. S. JENCKES, JR.,
EVERETT M. ROSS,

807 Title & Trust Building,
Phoenix, Arizona
Attorneys for Appellant.

FILED

NOV - 1941

PAUL P. O'BRIEN,

CLERK



Topical Index

Appellant's Reply to Appellee's Arguments.....	1
Issue I—Appellant did not have a policy of the type applied for by Rogers.....	3
Issue II—The evidence shows that there never was a legal delivery to Rogers of the Policy in Question	7
Issue III—Rogers was advised of the fact that Lindberg was without authority to extend credit for the payment of the First Premium	11
Conclusion	16

Table of Authorities Cited

CASES

Bloom v. Pacific Mutual Life Insurance Co., Calif. 1927, 259 Pac. 496	7
Snyder v. Nederland Life Ins. Co., 202 Pa. 161, 51 Atl. 744	16
Union Life Ins. Co. v. Homan, 74 N. W. 1090.....	16

TEXT BOOKS

Corpus Juris - Vol. 32 at page 1138	13
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IN THE
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Circuit Court of Appeals
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Appellee.

APPELLANT'S REPLY BRIEF

(References are to pages in the
Transcript of Record)

In the appeal of any law suit it is inevitable that the parties will not be in complete accord in their interpretations of the record. To infer that an interpretation contrary to one's own finds its basis solely in improper motives of the opposing party merely beclouds the legal issues involved. Appellee, in her brief, abuses each witness with whom she fails to agree and directs her rather histrionic appeal to the emotions rather than to reason. After censuring appellant's counsel for writing its brief in such a manner as to necessitate a lengthy reply, appellee indulges in a diatribe of not less than

fifteen pages regarding the conduct of appellant's agents after the death of Rogers. No attempt is made to show what bearing this could possibly have on the fundamental question of whether there was a contract of insurance in force at the time of Rogers' death. Appellee chooses to disregard the obvious fact that when an agent of a company suddenly dies, leaving the company's business in an incomplete state, it is most important that other members of the company step in and finish up that business. Appellee prefers to talk of "guile", "force and stealth" and "unclean hands". Though appellant at no time has asserted that it acquired any rights by regaining possession of the policy in question along with its other papers after Rogers' death, appellee boils with indignation over this irrelevant point. Likewise, appellant has never contended that the existence of an insurance contract at the time of Rogers' death could be affected by whether or not Rogers' heirs or personal representative subsequently paid appellant a premium on the policy. These have never been issues in the case. We feel, therefore, that it is necessary to redirect the Court's attention to the three questions actually involved, namely:

1. Did appellant issue a policy as applied for by Rogers or did it reject his offer by making a counter offer?
2. Does the evidence show that there was ever a legal delivery to Rogers of the policy in question?
3. Does the evidence show that Lindberg had either actual or apparent authority to waive the Company's requirement that the first premium be paid in cash?

Appellant Did Not Issue a Policy of the Type Applied for by Rogers.

In her statement of facts on page 7 of her brief appellee states, "In his application, Rogers, the insured, also agreed that any addition or amendments affixed to the policy were ratified and accepted by him." On referring to Pltf's. Ex. No. 3, Tr. 95, which is cited in support of this statement, we find that Rogers applied for a policy which would pay his beneficiary double the face amount thereof in the event Rogers' death resulted from operating or riding in an unlicensed aircraft. In the questionnaire which he signed pertaining to aeronautical activities Rogers in response to the question, "To what extent do you contemplate making use of any aircraft and in what capacity?" volunteered the statement, "In case of accident I *wave* all insurance." Though Rogers indicated that he had discontinued flying, appellant, nevertheless, issued a policy on the ordinary life plan but attached thereto a Permanent Aviation Clause rider which had the effect of lessening its burden if Rogers' death occurred while operating or riding in an unlicensed aircraft. Under this clause the beneficiary would receive only the reserve of the policy at the date of death instead of the face amount thereof or the double indemnity benefits. It is appellee's theory that since Rogers volunteered the ambiguous statement, "In case of accident I *wave* all insurance", appellant was not justified in issuing a policy with an aviation rider attached—that Rogers' attempted waiver rendered such a rider superfluous. No one will dispute the fact that appellant was under no obligation whatever to accept Rogers' offer. Sound business practice would not justify appellant in leaving unsettled the question of its lia-

bility in the event of Rogers' death in an aircraft. If appellant had issued a policy in the standard form with double indemnity benefits, would Rogers' statement have had the effect of releasing appellant from all liability in the event aeronautics was the cause of his death or would his beneficiary contend that because the policy contained no exceptions, appellant was liable for the face amount thereof, or even the double indemnity benefits? Appellant was justified in requiring, as a condition precedent to the completion of the contract, that Rogers execute a separate agreement for appellant's files, indicating his acceptance of the policy as modified by the rider. Appellee at page 73 of her brief states, "The evidence also showed that if there was an 'original sheet' of the Permanent Aviation Clause a duplicate of which was signed for him by the Company and attached to his policy—such original was never transmitted from the Home Office to the Local Office and that the Local Office did not have such original paper, and never presented or mentioned anything concerning it." She verifies this by citing her own statement of the facts. The instructions which accompanied the policy from the Home Office to the Arizona Office indicate that such an original was forwarded with the policy, for it states (Def's. Ex. No. C - Tr. 117), "Vital B. O. Before delivery of above policy the enclosed amend. must be signed, witnessed and returned to this office." Appellee on page 8 of her brief attempted to brush aside these instructions, stating that they are on a "stock or routine printed form" and that "This stock communication was designed to govern situations between salesmen and third parties, and was inapplicable in the instant situation." This latter conclusion is a pure figment of the imagination, having no support in the re-

cord. In fact, the Exhibit on its face shows that it pertained to Rogers' policy. Even more startling is appellee's statement, "The subject of this circular related to the waiver with respect to the aviation accidents. This was the waiver which Rogers had included and signed in his application." She concludes that Rogers' enigmatic waiver satisfactorily settled all questions that might arise and that it was, therefore, foolish for appellant to make a counter-offer which attempted to define its obligations more clearly. Mr. Caskey, the Cashier of appellant's Arizona Branch Office, explained the manner in which the policy and rider were handled (109):

"Q Would you explain to the jury, Mr. Caskey, how that is handled; what is done with the original?

"A Well, when an application goes to the home office, when you are applying for insurance on a certain plan, if they don't issue on that plan or modify your application or put a rider on it as in this particular case, they attach a copy of it to the policy and then the original which you accept is left unattached and it comes out with the policy is presented to him, well, then he has to accept the policy with the modifications. In other words, he accepts the policy with the modifications by signing the amendment or rider, whatever you want to call it, accepting it. In this particular case they modified his application by putting what they call a permanent aviation clause in there, which is a restriction on the hazard, and then if he

wants that policy that way, he has to sign that rider, that acceptance of that modification, otherwise there would not be anything (119) for him to sign. The acceptance of the policy the way it is and the payment of the premiums is satisfactory, you know, the conclusion of the deal.

“Q What is done with the original form of the rider after the applicant has signed it?

“A It is sent to the home office and filed and a copy of it is left in the policy.”

Appellee argues that appellant's act in typing Rogers' signature on the copy of the agreement which was inserted in the policy amounted “to an implied consent by Rogers to the condition” (Appellee's Brief 14). This line of thought we are unable to follow.

In response to a question as to how a policy is handled when the branch office receives it from New York, Caskey testified (120) “* * * it is sent to the agent and with it is a, what you may call an invoice form giving him certain instructions on there as to what to do or what not to do, requirements and different things of that sort.” In view of this testimony regarding the customary routine it is reasonable to infer that the policy was sent to Rogers with the original unsigned aviation agreement and with instructions similar to those which accompanied the policy from New York.

However, nothing is to be served by quibbling over what inferences should be drawn from the evidence on this point, for it is clear that even had Rogers paid the

initial premium in cash but had died while the policy was en route to the Arizona office, there would have been no liability. Appellant, by issuing a policy containing these modifications, was in effect making a counter-offer. Regardless of the fact that appellee considers such modifications to be superfluous, it was, nevertheless, a policy differing from that applied for, and until that policy was legally delivered to Rogers there could be no contract. The authorities cited in our opening brief clearly sustain this proposition. If the law were otherwise, insurance companies would be helpless to protect themselves against the confusion which results when an applicant volunteers a statement such as, "In case of accident I *wave* all insurance", and at the same time applies for a policy containing double indemnity benefits.

The case of *Bloom v. Pacific Mutual Life Insurance Co.* (Calif. 1927, 259 Pac. 496) cited by appellee on page 16 of her brief merely amounts to a holding that where a company delivers a policy unconditionally to an applicant with the intent that the insurance become immediately effective, the company thereby waives its objection to the applicant's previous failure to sign the application. It does not involve a situation where there is a counter-offer made by the company and there is no delivery of the policy constituting such counter-offer.

II

The Evidence Shows That There Was Never a Legal Delivery to Rogers of the Policy in Question.

It was a real challenge to the imagination of appellee's counsel to avoid the forceful effect of the evidence on this point, for said evidence is clear and uncontra-

dicted. Mr. Caskey testified that when the Branch Office receives from the Head Office a policy on an agent's own life it is the practice to hold the policy until the agent can come in and pay the premium and sign any amendments that are necessary (123). He further testified that this policy was forwarded to Rogers through error in office routine resulting from the fact that the typist who billed the policies out to the agents in groups of 75 or 100 did not recognize the name of Rogers (124). The policy was sent to Rogers in disregard of the above practice. As soon as Caskey discovered the mistake he wrote Rogers, advising him of the mistake, explaining the Company's practice where the agent was the applicant, and asking him to return the policy (129-D's Ex. E). Appellee implies that Caskey, scenting Rogers' death from afar, became frantic to get the policy back. "It is to be remembered that Caskey's letter of the 23rd could not reach Rogers until the date of his death, and that he (Rogers) would have no opportunity to suggest the existence of his credit arrangement with Mr. Lindberg, or to comply with any request to pay the initial premium (Appellee's brief 25)." Appellee attributes sinister motives indeed to Mr. Caskey. The inference to be drawn is that Mr. Caskey knew very well that the finger of death was pointed at Rogers and, therefore, wrote this letter in order to have some good evidence to use in the event of a law suit. This, we submit, is ludicrous. To strengthen her accusation appellee states, "This letter in the ordinary course of mail delivery would have reached Mr. Rogers about January 26, 1940, which was the date of his accidental death (Appellee's Brief 10)." There is, of course, no reason to assume that the U. S. mails would require three days to send a letter 250 miles. The evidence that the letter was found in Rogers' pos-

session after his death makes this point hopelessly weak (215).

But, says appellee, "He (Rogers) did not, therefore, remit the amount of premiums hoped for by Mr. Caskey, and thereupon, Mr. Caskey decided that he might improve the securities position of his company and hasten collections by the sending of his letter of January 23rd requesting Rogers to return his policy (Appellee's Brief 25)." These speculations of counsel find not the slightest support in the record. If such had been the case, why did not Mr. Caskey say, "The time for credit is up—please return the policy." Why did he go to the pains of writing: "The policy issued on your life was forwarded to you in error as until settlement of the first premium had been made in case we are not permitted to forward a policy to an agent on his life." Appellee, however, desperately continues to ignore the record and to draw facts from thin air: "When Caskey says that he first learned Rogers was holding his own (Rogers) policy when he received Rogers' report some time about January 15th he is mistaken—His own records and his own communications challenge his statement and establish the fact that he knew perfectly well that Rogers had this policy all the time" (Appellee's Brief 25). Appellee then cites Defendant's Exhibit D, which has not been designated as part of the record. This Exhibit consists of a statement which the Branch Office sends its agents on the 15th of every month for the purpose of obtaining a report on policies which had been billed out to the agent during the preceding thirty days (125). Because the report which was sent to Rogers listed his own policy along with many other policies which had been mailed to him, appellee concludes that Caskey knew all the time

that Rogers had the policy and was therefore merely indulging in a whimsey when he wrote the above letter advising Rogers of the mistake. Had appellee's counsel been a little less eager to smear Mr. Caskey's character he would have realized that the head of an office force consisting of twelve or fourteen clerks does not personally sit down each month and type out bulletins such as this to forty or more agents requesting information on hundreds of different policies which had been sent to them. Routine such as that obviously would be the duty of the clerks. Mr. Caskey testified that when this report was returned he audited Roger's account and learned for the first time that Rogers' own policy had been sent to him (125).

Appellee expresses disgust that appellant falls back on such truisms as "Legal delivery of policy to Rogers was essential to a consummation of the insurance contract (Appellee's brief 19)." On page 26 of our opening brief, we point out that under the authorities there cited the test for legal delivery is "whether the company or its agents intentionally part with control or dominion of the policy and place it in the control or dominion of the insured or some person acting for him with the purpose of thereby making a valid and binding contract of insurance." In the instant case the existence of the evidence relative to the mistake in mailing the policy is important in that it shows that there was a complete lack of the requisite intent to make a legal delivery. If a person having in his possession a \$10.00 bill and a \$100.00 bill, by mistake gives the \$100.00 bill to another person thinking that it was a \$10.00 bill, would anyone contend that he should not be allowed to correct the mistake? Because the mistake was not a "mutual" one, the unfortunate

person would not, under appellee's theory of the case, be permitted to recover his \$100.00 bill. Appellee cites a well recognized line of decisions holding that if one has entered into a contract with another he cannot later rescind that contract on the grounds of mistake unless there was "mutuality of mistake", etc. It is apparent that these decisions are in no way relevant to the proposition that there cannot be a legal delivery of a document where the requisite intent to part with possession of it is lacking. As the uncontradicted evidence in the record shows that the policy left appellant's possession as a result of error in office routine, there is no basis for contending that the requisite intent to make a legal delivery was shown. Needless to say, had this error not occurred and had the policy remained in appellant's files, there would never have been a law suit. To base a recovery on such a fortuitous occurrence as this, to say the least, is most inequitable.

III

Rogers Was Advised of the Fact that Lindberg Was Without Authority to Extend Credit for the Payment of the First Premium.

Although appellee accedes to the legal propositions we cite under this issue, she, nevertheless, asserts that this defense is purely "technical" and "restrictive". In an attempt to avoid the effect of the book entitled "Instructions to Agents" (Def. Ex. F) appellee states on page 2 of her brief: "There is no proof that such pamphlet or any other prepared office regulation respecting the issues of this case, were ever given by any authorized company official, to Rogers, the insured, or that the provisions of the 'Pamphlet' are observed in actual prac-

tice." We respectfully direct the attention of the Court to the following testimony of Mr. Caskey (210):

"Q Was Mr. Rogers given a copy of this set of instructions?

"A Yes, he was at the time he signed his contract papers."

It will be remembered that this Book of Instructions provided (Def's. Ex. F-Tr. 137): "The Company will not accept a note in payment of the whole or any part of the first premium on a policy. The Company will accept cash only in payment of a first premium. If an agent takes a note, he does so at his own risk and must be personally responsible for the same." Appellee argues that since the evidence shows that on occasions an agent would accept from applicants notes payable to the agent personally, the record supports her conclusions that the above instructions are not observed in actual office practice. This, we submit, is a non sequitur. Also, states appellee, "The book of instructions referred to, applied to soliciting agents. It is assumed such books of instructions were given to soliciting or local agents. There is nothing about the book or anything in the record to show that the instructions in such document related to or pertained to the duties and authority of Mr. Lindberg." (Appellee's Brief 35). This is a perplexing statement in view of the clear, unconditional statement in the Instructions to the effect that "The Company will accept cash only in payment of a first premium." It is difficult to find any basis for appellant's assumption that Mr. Lindberg, whom appellee designates as an "alter ego, the plenipotentiary, the factotum" of the Company, is an exception

to this rule. Though the record does show that, as provided in the above instructions, the Company's agents may take notes, it does not disclose any instances where the appellant company ever accepted anything other than cash in payment of the first premium when an applicant applied directly to it for insurance.

There is no ambiguity in the record on the appellant's method of doing business—a method which appellee designates as being “subtle and elusive”. As we have seen, the book entitled “Instructions to Agents” provides that the Company will accept cash only in payment of a first premium but that an agent may take a note. If he does so, however, it is at his own risk and he is personally responsible for the same. Mr. Lindberg testified that “The agents are permitted to take notes payable to themselves when they deliver a policy to the applicant, other than an agent of the Company (Tr. 205)” and that “If the note is not paid by the applicant, the agent has to pay the note (205).” From this testimony that agents are permitted to accept notes payable to themselves, appellee jumps to the conclusion that where the agent is an applicant the Company will cast aside its established rules and will extend credit to him. At the risk of again being accused of “intellectual dishonesty” we state that this conclusion does not logically follow. Because appellant's policies constitute receipts for the payment of the first premium (Tr. 156), if such a policy is legally delivered, there arises an irrebuttable presumption that such premium was paid. (32 Corpus Juris 1138) Thus an agent who delivers a policy without receiving cash may protect himself against the legal effect of these recitals acknowledging payment of the premium, only by taking a note or some other

evidence of indebtedness. If he delivered the policy without doing this, he would be unable to collect the first premium, for the recitals in the policy would estop him from contending that such premium had not been paid. It follows that a company would not deliver a policy directly to an applicant without taking steps to avoid the conclusive effect of the recitals in the policy that the premium had been paid. Since it was the Company's established rule not to accept notes but to accept cash only, it stands to reason that it would not deliver a policy to an agent where he was the applicant without first obtaining the premium in cash. Obviously, a company must trust its agents to remit the cash premium if they collect it or to remit cash in lieu of a premium if the agent assumes the risk of taking a note. In either case, the Company must rely on the honesty of its agents to send in premiums on the policy which they delivered. Under appellee's theory of the case the Company would be doing a credit business even though the agents collected nothing but cash from applicants, for "the Company would be relying on its agents to remit the cash—and therefore, in effect, is extending credit to them." There is not one instance where the Company extended credit to an applicant.

Appellant's practice of permitting agents to take notes payable to themselves to cover first premiums is immaterial here, for the reason that Rogers applied directly to the Company for his policy. The record is clear that the Company has consistently followed the practice of accepting nothing but cash in payment of the first premium.

Not only did the Book of Instructions advise Rogers

of this fact but the application which Rogers signed stated that the insurance applied for would not go into force until the first premium was paid in full (94-95). It further provided that only the President, a Vice-President, a Secretary or the Treasurer of the Company could waive any of the Company's rights or requirements. "The application, fairly construed," the appellee argues on page 36 of her brief, "related to the limitations on the authority of *soliciting* agents. Therefore, it cannot be argued that Rogers, as the assured, had any notice or knowledge of limits to Mr. Lindberg's authority." Since Lindberg was not one of those officers designated as being the *only* ones who were authorized to waive the Company's requirements, it is difficult to find any logic in appellee's argument that the application did not give Rogers notice that Lindberg lacked authority. The authorities cited on page 31 of our opening brief support the proposition that an applicant is put on notice of the limitations on the agent's authority which were set forth in the application. Appellee attempts to brush aside these decisions, saying that they involve mere *soliciting* agents. If any legal effect is going to be given to a clause providing that only certain officers can waive a condition of the application, the rank of the agent attempting to make such waiver can have no bearing on the question if, in fact, he is forbidden to waive. In the absence of facts giving rise to an estoppel courts have consistently upheld the right of a principal to limit the authority of its agents by these non-waiver provisions in the application.

In support of the proposition that a general agent may waive a stipulation in a policy that no liability shall attach until the first premium is paid, appellee at page

36 of her brief cites *Snyder v. Nederland Life Ins. Co.*, 202 Pa. 161, 51 Atl. 744. An examination of the case discloses that there were no limitations whatever placed on the authority of the general agent. The case was decided in accordance with the general rules of law regarding apparent authority. It is not applicable to the instant case where both the application and the Book of Instructions advised the applicant of the general agent's lack of authority. The case of *Union Life Ins. Co. v. Haman*, 74 N. W. 1090, which appellee cites on page 36 of her brief, is likewise inapplicable for the same reasons. In fact, appellee cites numerous cases relative to the apparent authority which a general agent ordinarily has. The fact that Rogers as one of appellant's agents was conversant with appellant's regulations and had notice of the limitations on Lindberg's authority is consistently ignored. We submit that because of Rogers' knowledge of these limitations, the doctrine of estoppel and apparent authority have no application in the instant case. Nothing would be gained, therefore, by discussing the numerous cases appellee cites in support of these general propositions of law.

Conclusion

There is a notable lack of conflict between the legal authorities cited by appellee and those cited by appellant. On the interpretation of the record, however, there is considerable dispute. We submit that the record is clear and convincing as to the existence of the following facts on which our conclusions of law are predicated:

(a) The policy was forwarded to Rogers as a result of error in office routine.

(b) Rogers, as an applicant and as a man engaged in soliciting insurance for appellant, was put on notice by the terms of the application, and also by the book of instructions, that Lindberg was without authority to waive the Company's requirement that the first premium be paid in cash.

It is reasonable to conclude that had the above error not occurred and had the policy remained in appellant's possession, this litigation never would have been instituted.

Respectfully submitted,

ELLINWOOD & ROSS,
JOS. S. JENCKES, JR.,
EVERETT M. ROSS,

IN THE
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REPLY TO PETITION FOR REHEARING

JOHN FRANCIS CONNOR,
DOUGHERTY & CHANDLER,
516-19 Heard Bldg.,
Phoenix, Arizona,
Attorneys for Appellee.

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MAY - 7 1942

PAUL P. O'BRIEN,
CLERK

TOPICAL INDEX

Issue I—Telephone Conversation re, Credit.....	1
Issue II—General Agents actual or ostensible authority	4
Issue III—Effect of failure to sign aviation rider.....	6
Issue IV—Instruction No. IV Not Prejudicial.....	9

TABLE OF AUTHORITIES

Adamson v. McKeon, 225 N. W. 414, 65 A. L. R. 817.....	10
Bradford v. U. S., 33 S. Ct. 1026, 57 L. Ed., 1630.....	4
Brooks v. Neer (Ariz.) 47 P. (2d), 452.....	6
Columbia Heights Realty Co. v. Rudolph, 217 U. S. 547, 54 L. Ed., 877.....	11
Crozier v. Noreiga, 27 Ariz. 409, @ p. 416, 233 P. 1104.....	6
Dayton Power & Light Co. v. P. R. Comm., 219 U. S. 290, 78 L. Ed., 1267.....	12
Donehy v. Com., 170 Ky. 474, 186 S. W. 161, 3 A. L. R., 1161.....	11
Gamache v. Piquignot, 16 How. 451, 14 L. Ed., 1012.....	11
Gatzow v. Buening, 106 Wis. 1, 81 N. W. 1003.....	12

Goupier v. Grand Tr. R. R. Co., 96 Vt. 191, 118 A. 586, 30 A. L. R. 690.....	11
Holoway v. Dunham, 170 U. S. 615, 42 L. Ed. 1165.....	11
Ill. Bankers' Life Association v. Theodore (Ariz.) 34 P. (2d) 423 @ p. 428.....	6
N. Y. C. & H. R. R. Co., v. Fraloff, 100 U. S. 24, 25 L. Ed., 531.....	12
People v. Doyle, 48 Calif. 85.....	11
Ross v. Kay Copper Co., 20 Ariz. 576, 184 P. 978.....	12
So. Pacific Co. v. Schoer, 114 F. 466, 57 L. R. A., 707.....	12
Stephenson v. So. Pac. Co., 102 Calif. 143, 34 Pac. 618.....	11
Warfield Nat. Gas Co. v. Clark, 79 S. W. (2d) 21, 97 A. L. R., 971.....	11

TEXTS

Hayne, New Trial & Appeal, Vol. 2, Sec. 288, p. 1614.....	12
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IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

NEW YORK LIFE INSURANCE COMPANY, a
corporation,

Appellant,

vs.

LOIS ROGERS,

Appellee.

REPLY TO PETITION FOR REHEARING

Comes now, Lois Rogers, Appellee in the above entitled Cause and in resistance to Appellant's Petition for Rehearing, replies to the respective numbered grounds set out by Petitioner, as follows:

I.

Whether policy was in possession of insured at time of telephone conversation, between witness Clem and Lindberg, General Agent, re credit, is not solely determinative of extension of credit.

Appellant contends that the jury's findings that there was an extension of credit was justified by the

Court, apparently on the assumption that at the time of the telephone conversation in question, "Rogers was in possession of the policy."

The testimony of Mr. Clem is that this conversation was held during "the latter part of December" (T. 178). Appellant asserts that Lindberg's remarks concerning payment of premium is consistent with the assumption that the policy was not in Rogers' possession at that time. Lindberg's remarks are equally as consistent with the converse assumption. With respect to the policy *not* being in possession of the insured, at the time in question, there is a total lack of evidence.

A reading of the Opinion discloses that the observation of the Court, to-wit: "At that time Rogers was in possession of the policy" had no necessary essential relation to the reasoning of the Court, that the jury could have found that Mr. Lindberg intended to issue the policy on credit. The Court indicated that the jury might so find because of the evidence showing the telephone conversation of Mr. Lindberg to have been directly connected with the theory that credit was extended. The words of the Court, to which Appellant attaches such significance need not necessarily have been written within the paragraph in question at all. The possession of the policy at the time of the telephone conversation is not conclusive. Rather the delivery and possession of the policy at some time during the life of the insured, in pursuance of the agreement to extend credit, is the essential factor, and there was ample evidence on that point for the jury to consider.

Other factors such as the conversations and actions of Mr. Lindberg with Mrs. Rogers, as substantiated by her son Gale Rogers, were matters which lent credence

to the theory of extension of credit. So also was the evidence with respect to the common practice of the Company with regard to similar policies a factor, as well as a variety of other circumstances which were in evidence before the jury.

Even if the policy had not been in Rogers' possession at the time of the telephone conversation, that fact does not necessarily indicate that an agreement for the extension of credit or waiver of the cash premium had not been made. It is equally as plausible that at the time of the conversation, the agreement to extend credit had previously been made, - - the delivery of the policy, subsequent to such conversation, if indeed, the delivery was made later, would only be confirmatory of such extension agreement, and the delivery of the policy in pursuance thereof would have made such agreement binding, or an agreement fully executed.

This matter was fully argued and considered by the Court in the former hearing, and the point made by Appellant in its Petition for Rehearing is immaterial and could not affect the result. The expression of the Court, concerning the policy being in the possession of Mr. Rogers "at that time," is not a connecting premise qualifying or supporting the reasoning that because of the gist of the telephone conversation, the jury was justified in finding an intent to extend credit.

"A rehearing will not be granted by the * * * Court because of an inadvertent form of expression in its opinion which could have had no possible influence upon the reasoning stated therein which rendered it necessary

to affirm the judgment below.”

Bradford v. U. S.

33 S. Ct. 1026,

57 L. Ed. 1630.

II.

It was not error to submit to the jury the question of General Agent's actual or ostensible authority to extend credit.

Under this contention, Appellant asserts that the Appellate Court fell into error through recognizing general legal principles not applicable to the circumstances involved here.

We fail to see where the Court “has fallen into error.”

It is unnecessary to again argue the facts concerning Mr. Lindberg's apparent or ostensible authority to have made the credit arrangement. The evidence with all its implications and inferences was for the jury to determine. The facts indisputably established that the Company issues and delivers the policies on a credit basis, and that said deliveries were made without the payment of the initial premium in cash, and also such routine practice was the regular practice of the Company. (T. 142-144, 156).

We can see little point in the distinction and implications by Petitioner, that it was soliciting agents who followed such practice. Certainly if soliciting agents pursued such a customary course of conduct, it may well be considered as conclusive that the General Agent had ostensible or apparent authority to extend credit, or waive policy provisions, and the formula which he chose to ad-

opt or the technique by which the arrangements were effected, would be immaterial.

It is also intimated that the "uncontroverted" facts show that when an Agent applied for insurance on his own life, Appellant's Branch Office employees were not permitted to deliver the policy to him until pre-payment of the first premium. The reference is to the transcript at p. 123. This is the testimony of Mr. Caskey, Cashier of the Company and an interested witness.

Pages, 211 and 212 of the transcript on recross-examination of Mr. Lindberg, the General Agent, shows that the Appellant was unable to find any substantiating evidence in support of Mr. Caskey's statement. We quote from the record, (T. 212), as follows:

"Q. You extend credit to the agent, that is right isn't it?

A. Yes, where the applicant is some one other than an Agent of the Company.

Q. Well it does not say anything about that in here, does it?

A. I don't know.

Q. I will ask you to examine it and see if you can find anything (handing document to witness)?

A. I am quite sure there is nothing in here that says anything about that."

If it were the practice of the Company to refuse credit to the Agent on his own life there was no evidence that such a peculiarly restrictive rule was brought to the attention of Rogers.

Moreover, the testimony of Mr. Lindberg (T. 212),

controverts the testimony of the Company's own Cashier at p. 123 of the transcript.

We take it to be the law that testimony offered by the Company's witness, even if in part, not specifically contradicted by testimony of adverse witnesses, doesn't imply that the jury must accept such statements as sacrosanct.

The Court or jury is not required to believe or accept as true testimony of witnesses although not contradicted by direct evidence. *Crosier v. Noreiga*, 27 Ariz. 409 @ p. 416, 233 P. 1104; *Ill. Bankers' Life Ass'n. v. Theodore*, (Ariz.) 34 P. (2d) 423 @ 428; *Brooks v. Neer*, (Ariz.) 47 P. (2d) 452 @ 456, Col. 1;

The jury might well consider the bias or interest of witnesses as well as the fact that the testimony, although uncontroverted, may be inconsistent and not entitled to credit, or that it is improbable or that the manner of testifying on the part of the witness casts a doubt upon the truth of his or her statements - - all the surrounding circumstances of the particular transaction in question may refute and directly or impliedly contradict the evidence.

III.

The failure to sign the aviation rider, in the manner desired, in the absence of notice, would not preclude policy from becoming effective.

This Court found, under the facts of the instant case, that it was not necessary for Rogers to have signed the aviation rider. That conclusion was based upon the finding that "there is no evidence that such requirement was brought to the attention of the insured." (Opin. p. 5).

Appellant objects to this conclusion and attempts to make a specious distinction, in that while no *specific* testimony was offered that Rogers was instructed to sign the rider, yet the inferences to be drawn from Mr. Caskey's testimony set out at p. 5 of Petition for Re-hearing, (T. 109), and (P. 6, of Petition; - - T. 120), permitted the presumption that Rogers was informed of such requirement by virtue of an "invoice form" (P. 7, Petition).

With reference to this testimony of Mr. Caskey's (T. 109), it may be observed that he was referring not to the particular application of Rogers, as a distinct individual but rather he was alluding to a suppositious or fictitious applicant.

With regard to the testimony offered (T. 120), again, we desire to point out that this testimony relates in part, to what was done with reference to Mr. Rogers' policy, and in part, it is a recital of what is *generally* done, but it is not in any manner indicative of the fact that this so-called "invoice form" was ever sent to Rogers.

Appellant testified, (T. 123), in effect that when a policy is issued on an Agent's own life, the Company holds the policy and tells him upon payment of the premium the policy will be sent to him. Now if this were the true practice of the Company, then there would have been no reason to have sent this so-called "invoice form" to Rogers at all. The mailing of such forms, if ever dispatched, has reference to those cases, where a soliciting agent is given certain instructions prior to the delivery of the policy to an insured who constitutes one of the general public.

Mr. Caskey testified at the opening of the case that the policy as handed to him when on the stand as a witness, was in the same form and condition as when it was originally mailed to Mr. Rogers. He stated:

"It appears all to be there." (T. 80).

It will be remembered that the policy in question was taken from Mr. Rogers' effects after his death by the General Agent. The jury might also have thought that if either the so-called "invoice form" or "rider" was ever sent to Mr. Rogers for signature, then one or the other of the instrumens would have been found with the policy. Neither the "invoice form" or the "rider" ever appeared in evidence. Further at pp. 110 and 111 of the transcript, referring to the instructions sent by the Home Office to the Branch Office, the question was asked of Mr. Caskey as to whether or not he had ever shown such instructions or letter to Mr. Rogers. Mr. Caskey answered:

**"No, I never saw Mr. Rogers"
and:**

"No, he would never see that letter."

Now, it certainly is not sufficient for the granting of a rehearing that the Appellant offer merely the "presumption" that an "invoice form," which was not shown to have been actually sent to Mr. Rogers, would be tantamount to putting the insured on notice as to the necessity of signing a certain rider or amendment.

Furthermore the whole impression sought to be created by Appellant in its case in the Lower Court was to the effect that in instances where policies were issued on the Agent's own life, that *special procedure* was there followed; therefore, the testimony of Mr. Caskey as to general routine practice in ordinary cases, cannot

be inferred to have any applicability to the Rogers case.

It thus follows that the predicate upon which the Court founded its conclusion, namely: "there is no evidence that such requirement was brought to the attention of the insured," is abundantly sustained by the record.

As a consequence, it may be perceived that the Court's further conclusion that Rogers had the right to adopt and did adopt the typewritten signature on the aviation rider as his own, was a necessary logical deduction, which was eminently correct.

IV.

Instruction No. IV. was not prejudicial to Appellant.

Appellant asserts that the Lower Court's instruction No. IV being erroneous, was also prejudicial in that it, in effect, took from the jury the issue with respect to whether or not Rogers knew of and had complied with provisions requiring his signature on the rider.

The answer to such contention is that there was no evidence offered by Appellant on the point, inferences and presumptions from the so-called "invoice form" to the contrary notwithstanding. If no evidence on the issue were offered, obviously, there would be nothing, which, in effect, could be withdrawn from the jury's consideration. The whole purport and tenor of Appellant's testimony was that the Home Office had forwarded the policy to the Branch Office for delivery, contingent on certain conditions. (T. 109-125). The Appellant offered no evidence whatsoever that knowledge of any of these conditions, was brought to the attention of the insured.

The only possible testimony touching upon the point of knowledge to Rogers, was adduced by the plaintiff, as negative evidence on cross-examination establishing that no memoranda or other indicia of knowledge were ever sent to Rogers, or found with the policy. It may be contended that the instruction complained of, might have embraced the factor that the jury should find, one way or the other, with respect to notice, yet we respectfully suggest that inasmuch as there was no evidence-in-chief offered on the point, the instruction, under the law of the case, was not prejudicial.

No prejudice can be predicated upon an error which relates to a part of the case which is found or determined against the objecting parties.

“Error in instructing or failure to instruct as to the law applicable to a defense raised is without prejudice where the finding of the jury for the plaintiff must, under the instructions given them, be taken as negating the existence of the facts upon which such defense was based.”

Adamson v. McKeon
225 N. W. 414,
65 A. L. R. 817

Even assuming that the instruction had been qualified in such manner as to point out to the jury that it should find whether or no Rogers had such knowledge, can it be said under all the evidence that the jury's verdict would have been different? Obviously not, where there was no evidence on the part of the Appellant that Rogers was so notified, and of course, it follows that not having been notified of the necessity to sign such rider, he could not be bound thereby.

A party should not be heard to complain of the

failure or omission of an instruction, where, under the proved facts, the verdict would necessarily have been the same if the instruction had been given. *Warfield Nat. Gas Co. v. Clark*, 79 S. W. 2d 21, 97 A. L. R. 971.

It is hardly necessary to reiterate that the judgment should not be disturbed because the particular instruction does not contain all the conditions and limitations which might be therein embraced. Instructions are to be read and considered as a whole, and the fact that when taken separately, some of them may fail to enunciate in precise terms and with legal accuracy propositions of law, does not necessarily render them erroneous or prejudicial. It is sufficient if all the instructions taken together give the jury a fair and understandable notion of the law regarding the point discussed. *Columbia Heights Realty Co. v. Rudolph*, 217 U. S. 547, 54 L. Ed. 877; *People v. Doyle*, 48 Calif. 85; *Holoway v. Dunham*, 170 U. S. 615, 42 L. Ed. 1165; *Gamache v. Piquignot*, 16 How. 451, 14 L. Ed. 1012; *Stephenson v. So. Pac. Co.*, 102 Calif. 143, 34 Pac. 618.

There is nothing in Appellant's objection to the instruction which would indicate that a new trial would result in a different verdict based upon the same evidence.

The defendant is not prejudiced by the Court's failure to instruct as to the law where there is an absence of evidence on the points raised. *Goupier v. Grand Tr. R. R. Co.*, 96 Vt. 191, 118 A. 586, 30 A. L. R. 690; *Donehy v. Com.*, 170 Ky. 474, 186 S. W. 161, 3 A. L. R. 1161.

No judgment should be reversed by reason of any error, instruction or defect, unless it appears that the error complained of was prejudicial to the substantial

rights of the Appellant. Error going only to immaterial, minor, or technical questions is not ground for reversal, especially where it does not touch the controlling questions of the case. *Dayton Power & L. Co. v. P. U. Comm.*, 219 U. S. 290, 78 L. Ed. 1267; *So. Pac. Co. v. Schoer*, 114 Fed. 466, 57 L. R. A. 707; *Ross v. Kay Copper Co.*, 20 Ariz. 576, 184 Pac. 978; *Gatzow v. Buening*, 106 Wis. 1, 81 N. W. 1003; *N. Y. C. & H. R. R. Co. v. Fraloff*, 100 U. S. 24, 25 L. Ed. 531.

Where there is substantial conflict in the evidence on the whole case, the Appellate Court will not disturb the decision of the Lower Court. *Hayne, New Trial and Appeal*, Vol. 2, Sec. 288, p. 1614.

In the instant case, there was substantial conflict on all the material facts presented for determination, and the general verdict having been rendered in favor of the plaintiff, it follows that the jury found against the defendant on all the issues involved.

WHEREFORE, it is respectfully urged that no sufficient grounds appear for the granting of a rehearing in this case, and the Petition of Appellant should be denied.

Respectfully submitted,

JOHN FRANCIS CONNOR,

DOUGHERTY & CHANDLER,

BY



Attorneys for Appellee.

United States
Circuit Court of Appeals
For the Ninth Circuit.

FONTANA POWER COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the United States
Board of Tax Appeals.

FILED

OCT - 4 1941

PAUL F. O'DRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

FONTANA POWER COMPANY, a corporation,
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	Page
Agreed Statement of the Case Under Rule 76, With Statement of Points Incorporated Therein	1
Exhibits to Agreed Statement:	
1—Findings of Fact and Opinion.....	5
1A—Decision of Board of Tax Ap- peals	21
2—Petition for Review of Decision of the Board of Tax Appeals	22
3—Supplemental Application to Rail- road Commission	25
4—Excerpts from Decision No. 3773 of Railroad Commission of Cali- fornia dated October 10, 1916	28
5—Agreement dated January 30, 1917 Between Fontana Company and Fontana Union Water Com- pany	31
6—Decision No. 4376 of the Railroad Commission of California dated June 6, 1917	36

	Page
Agreement Dated January 30, 1917 Between Fontana Company and Fontana Union Water Company	31
Application to Railroad Commission, Supple- mental	25
Certificate of Clerk to Transcript of Record.....	39
Decision of Board of Tax Appeals	21
Decision No. 3773 of the Railroad Commission, Dated October 10, 1916, Excerpts from	28
Decision No. 4376 of the Railroad Commission of California Dated June 6, 1917	36
Designation of Contents of Record on Review..	41
Excerpts from Decision No. 3773 of the Rail- road Commission Dated October 10, 1916	28
Findings of Fact and Opinion	5
Opinion	13
Petition for Review	22
Review:	
Designation of Contents of Record on	41
Petition for	22
Statement of Points on	40
Supplemental Application to Railroad Commis- sion	25
Statement of Points on Review	40

United States Circuit Court of Appeals
For the Ninth Circuit

BTA No. 99767

FONTANA POWER COMPANY,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

AGREED STATEMENT OF CASE ON APPEAL

Pursuant to Rule 76 of the Rules of Civil Procedure for the District Courts of the United States, the parties, by their respective counsel, make and sign this Statement of Case, as follows:

1. Prior to March 21, 1941, there was pending before the United States Board of Tax Appeals (hereinafter called "Board") a proceeding in which Fontana Power Company, a corporation (appellant above named), was petitioner and Commissioner of Internal Revenue (appellee above named) was respondent. The Commissioner determined a deficiency in income taxes and excess profits taxes of appellant for the years of 1935, 1936 and 1937. In making such determination, the Commissioner disallowed as deductions, payments made by appellant to Fontana Union Water Company, during said years, pursuant to a contract in writing of which a copy is hereinafter set forth. (Exhibit 5 hereof.) [1*] In said

*Page numbering appearing at foot of page of original certified Transcript of Record.

proceeding, the Commissioner contended such payments were not allowable as deductions under the Internal Revenue Code and appellant claimed said payments were allowable deductions (a) as interest and (b) as ordinary and necessary expenses of appellant's business.

On March 21, 1941, the United States Board of Tax Appeals promulgated its findings of facts and opinion in which the contentions of the respondent on review were sustained and the contentions of the petitioner on review disallowed; and on March 29, 1941, the Board entered its decision redetermining the tax liability in accordance with its opinion and findings of fact. Attached hereto and made a part hereof are copies of such opinion and findings of fact and decision of the Board, being marked Exhibits 1 and 1A.

2. Said decision was rendered on March 29, 1941, and within three months thereafter, appellant filed with said Board a petition for review of said decision by the above entitled Court. A copy of said petition for review is attached as Exhibit 2 hereto.

3. The facts found or stated in the findings of fact of said Board (which findings are set forth in Exhibit 1) are hereby adopted and made a part of this Statement of Case as fully as though here repeated, provided any fact or statement in said findings in conflict with any fact or statement appearing from or in any other instrument incorporated in this Statement, or in conflict with any fact or statement hereinafter contained, shall give way to and

be controlled by the fact or statement in such other instrument or hereinafter contained. [2]

4. Attached, and by reference incorporated herein, are copies of instruments (or portions of instruments) referred to in said findings, as follows:

(a) Supplemental Application to the Railroad Commission of California filed prior to October 10, 1916, as Exhibit 3 hereof. This application was executed and verified by each of Fontana Power Company, Fontana Company and Fontana Union Water Company. The caption, signatures and affidavits are omitted from the copy;

(b) Decision No. 3773 of Railroad Commission rendered October 10, 1916, as Exhibit 4 hereto. Omitted from the copy are the caption and all parts other than those portions directly referring to the contract involved in this proceeding;

(c) Contract entered into on June 15, 1917 (but dated January 30, 1917), pursuant to which the payments involved in this proceeding were made, as Exhibit 5 hereto;

(d) Third Supplemental Order of said Railroad Commission, dated June 6, 1917, as Exhibit 6 hereto.

5. The contract (Exhibit 5) was executed pursuant to authorization contained in said Decision 3773 of the Railroad Commission (Exhibit 4) and in said Third Supplemental order (Exhibit 6).

6. The bonds issued by appellant referred to in said findings were serial bonds maturing annually from December 1, 1921 to December 1, 1946, inclusive.

7. The amount of income on which said taxes were [3] assessed, the amount in dispute, and the amount not in dispute, for each year involved in said proceeding are as stated in the following tabulation:

	Amount of income not in dispute.	Amount of income in dispute	Amount of income on which taxes were assessed
1935	\$ 6,930.17	\$18,262.39	\$25,192.56
1936.....	1,919.93	16,244.55	18,164.48
1937.....	15,114.98	27,000.00	42,114.98

The amount of income in dispute for any year corresponds with the payments made that year by appellant to Fontana Union Water Company, under paragraph 4 of said contract (Exhibit 5), which payments the Board held were not allowable as deductions.

8. The points relied on by appellant on appeal are:

(a) Said decision is contrary to law in that thereby income taxes and excess profits taxes for the years 1935, 1936 and 1937 are imposed upon amounts in excess of appellant's net taxable income for said years, respectively, such excessive amounts corresponding with and being equal to payments made by appellant to Fontana Union Water Company, as follows:

For 1935, the sum of \$18,262.39;

For 1936, the sum of \$16,244.55;

For 1937, the sum of \$27,000.00;

(b) Said Board erred in holding that said payments of \$18,262.39, \$16,244.55 and \$27,000.00 were

not deductible from appellant's gross income for the respective years paid; [4]

(c) Said Board erred in holding said payments were distributions in the nature of dividends;

(d) Said Board erred in holding said payments were not interest;

(e) Said Board erred in holding said payments were not ordinary and necessary business expenses.

GEO. W. HELLYER,

JOHN B. SURR,

Counsel for Appellant.

J. P. WENCHEL,

Counsel for Appellee.

Approved and ordered Filed:

JOHN W. KERN

Board Member. [5]

EXHIBIT 1

United States Board of Tax Appeals

Docket No. 99767.

Promulgated March 21, 1941.

FONTANA POWER CO.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitioner was incorporated in 1916, all of its capital stock (except for qualifying shares) being

issued to the Fontana Co. and the Fontana Water Co., from which companies it acquired title to property necessary to the operation of its business. By contract it agreed to pay these companies an amount equal to the difference between the value of the stock and the value of the property, to be later determined, and pending such determination to pay to them all of its net profits. Later the Fontana Water Co. acquired from the Fontana Co. all of its stock and rights under this contract. The value of the property was never determined and the petitioner has continued to pay to the Water Co. all of its net profits. Held, that such payments during taxable years of 1935, 1936, and 1937 were distributions in the nature of dividends.

George Hellyer, Esq., and James W. Bontems, C. P. A., for the petitioner.

Samuel Taylor, Esq., for the respondent.

This proceeding involves income and excess profits tax liability for the years 1935, 1936, and 1937. The Commissioner determined deficiencies in income tax in the amounts of \$2,536.66, \$1,758.22, and \$3,130.50, respectively, for those years; and deficiencies in excess profits tax in the amount of \$922.42, \$189.87, and \$2,787.58, respectively. The petitioner seeks a redetermination of those deficiencies. The question presented is whether petitioner may deduct from its gross income certain payments made by it to its sole stockholder, which amounts petitioner asserts were payments of interest and respondent asserts were distributions in the nature of dividends.

FINDINGS OF FACT.

The parties have fully stipulated the facts in this proceeding, and, as stipulated, we have adopted those facts, which are materially as follows:

The Fontana Power Co., petitioner herein, was incorporated under the laws of the State of California on or about April 3, 1916, [6] and at all times since has functioned as a public utility corporation, subject to the jurisdiction of and regulation by the Railroad Commission of the State of California. Its principal place of business is at Fontana, California.

The Fontana Union Water Co., hereinafter called the Water Co., was incorporated in 1912 under the laws of the State of California as a mutual water company for the irrigation of farm lands in the vicinity of the town of Fontana. The Water Co. has been held by the Bureau of Internal Revenue to be exempt under section 101 of the Revenue Acts of 1934 and 1936 from income and capital stock taxation.

The Fontana Co. was incorporated under California law prior to petitioner, and continued to be so incorporated until it was dissolved in 1927.

A. B. Miller was president of all three corporations.

Prior to August 9, 1916, the petitioner made application to the Railroad Commission of California for a certificate that public convenience and necessity require the construction of an electrical power plant and system near the town of Rialto; and for

leave, inter alia, to execute a mortgage on its properties and to issue thereunder \$350,000 face value of first mortgage 6 percent bonds, and for leave to acquire from the Water Co. and the Fontana Co. certain properties and property rights. Thereafter, prior to October 10, 1916, petitioner filed with the commission a supplemental application reciting that it appeared impossible at that time to prepare and submit to the commission data sufficient to enable the commission to fix the value and approve the purchase price of the properties proposed to be conveyed by the Water Co. and the Fontana Co. to petitioner. The application stated that petitioner had an option to purchase certain steel required for use in construction of its proposed pressure pipes, which option would expire October 6, 1916, after which time the price of steel would be considerably higher due to the wartime market. In order to prevent the loss of this steel contract and allow further time in which to prepare data for the commission respecting the fixing of the value and approval of the purchase price of the properties, it was proposed to enter into an agreement providing for the immediate conveyance of the properties to petitioner for the consideration of: (1) 100 shares of capital stock in the petitioner corporation; (2) petitioner's covenant to pay the Water Co. and the Fontana Co. the difference between the value of the 100 shares and the value of the properties so to be conveyed as soon as the value and the method of payment could be agreed upon between the three corporations

and approved by the commission; and, (3) the further covenant of petitioner that, pending the fixing of the value and making of payment, the petitioner, from time to time, would pay over to the Water Co. and the Fontana Co. [7] all its earnings remaining after paying or providing for payment of its operating expenses, taxes, and interest and all obligations it might have incurred or for which it might have become responsible.

Thereafter, on October 10, 1916, the Railroad Commission of California made and rendered its decision granting petitioner authority to issue the 100 shares of capital stock of the par value of \$100 per share as part payment to the Water Co. and the Fontana Co. for a powerhouse site and certain property rights and to issue the \$350,000 of its first mortgage 6 percent bonds upon certain conditions, and granting authority to petitioner to enter into the proposed contract with the Water Co. and the Fontana Co. on the proposed terms, conditioned upon the approval by the commission of a copy of the contract to be thereafter filed by petitioner. The commission also declared that public convenience and necessity required the construction by petitioner of the proposed hydroelectric power plant and system.

Thereafter, on January 30, 1917, the Railroad Commission of California issued a supplemental order approving the mortgage and trust deed, which approval was the condition precedent to the issuance of the mortgage bonds. The supplemental order

recited that the \$350,000 6 percent mortgage bonds were to be secured by a mortgage upon all the property then owned or thereafter to be acquired by petitioner.

On February 6, 1917, the Railroad Commission of California issued a second supplemental order, re-approving the mortgage and trust deed in slightly amended forms. Thereafter, on June 6, 1917, the commission, by its third supplemental order, authorized petitioner to enter into a contract with the Water Co. and the Fontana Co. substantially in the form of the contract as filed with the commission on February 23, 1917, which contract has heretofore been set out in substance.

Thereafter, on June 15, 1917, petitioner entered into the contract with the Water Co. and the Fontana Co. and the latter two corporations conveyed the properties and rights to the petitioner. Pursuant to the commission's order petitioner also executed the trust indenture, and bonds of petitioner in the amount of \$350,000 were issued and sold under the indenture, and the proceeds were used in the development of petitioner's property. The properties and rights acquired from the Water Co. and the Fontana Co. were leased by petitioner to the Southern California Edison Co. for 30 years, commencing July 1, 1917, and were mortgaged by petitioner under the trust indenture to secure its bond issue.

When petitioner was incorporated, 5 qualifying shares were issued. Thereafter, pursuant to the commission's order authorizing the contractual agree-

ment with the Water Co. and the Fontana Co., petitioner issued to the Fontana Co. 50 shares of stock and a like number [8] to the Water Co. In 1927 the Water Co. acquired the 50 shares originally issued to the Fontana Co., and also acquired all interests and rights originally acquired and owned by the Fontana Co. under the agreement; and at all times since the Water Co. has been, and still is, the owner of the 100 shares of stock and of all rights originally acquired by the Fontana Co. and the Water Co. in and under the agreement. These 105 shares of stock are the only shares of petitioner corporation which have ever been issued.

During the year 1937 the Water Co. and the petitioner executed an agreement for the purpose of construing and resolving the meaning of certain provisions of the original agreement. By this 1937 agreement petitioner was allowed to deduct from its gross income, when calculating net income for the purposes of the original agreement, all charges for discount of its outstanding bonds and any expense in connection therewith. By order of October 25, 1937, the Railroad Commission of California approved this interpretation of the agreement.

During the year 1917, petitioner constructed the proposed hydroelectric plant on the powerhouse site, and also constructed pipe lines along the right of way conveyed to it by the Water Co. and the Fontana Co. Aside from income arising out of its business, petitioner never acquired any property of substantial value other than that conveyed to it by the deeds from the Water Co. and the Fontana Co., and

the improvements acquired with the proceeds from the sale of the bonds.

Commencing July 1, 1917, and at all times since its construction, the plant has been operated by the Edison Co. under the lease whereby petitioner reserved and receives electricity generated in said plant for supplying its customers, and the Edison Co. pays a rental determined by and based upon the excess power generated in the hydroelectric plant. At all times since the plant's erection the only business of petitioner has consisted of supplying its customers in the Fontana territory with electric power, either generated at its plant, or, in the case of a deficiency for its requirements, purchased and received by petitioner from the Edison Co.

The amounts claimed by petitioner as deductions from gross income, which amounts were disallowed by respondent (being \$18,262.39, \$16,244.55, and \$27,000 for the years 1935, 1936, and 1937, respectively), were paid by petitioner to Water Co. pursuant to that provision of the agreement between the corporations calling for the payment of all annual net income.

[The value of the properties and rights conveyed to petitioner by the Water Co. and the Fontana Co. has not yet been fixed, and the method of payment of the remainder of the purchase price thereof has not yet been determined, and, since the commencement of peti- [9] tioner's operations in 1917, all of its net income in excess of operating and other expenses and an 8 percent dividend on its outstand-

ing capital stock has been paid to the Water Co. and the Fontana Co., pursuant to the agreement between the three corporations.]

No orders have been issued by the Railroad Commission of California bearing on the valuation of the properties conveyed to petitioner or bearing on the agreement between the three corporations or the lease to the Southern California Edison Co. or the trust indenture or the bonds issued thereunder other than the orders mentioned above.

No attempt has at any time been made by petitioner to fix the value of the properties conveyed to it or to secure the approval of the Railroad Commission of California to the fixing of that value other than the mention of the value of \$349,500 in the amended application of petitioner to the commission in October 1916. Petitioner has never made any of the payments provided for in the agreement other than to issue the 100 shares of stock and the payments of income, as per agreement, as set out above.

In its annual reports to the Railroad Commission of California and in its Federal tax returns from 1917 to date, petitioner has deducted from its gross income the payments made by it pursuant to the agreement with the Water Co. and the Fontana Co.

OPINION.

Kern: In the original petition filed with this Board the taxpayer claimed that the amounts paid to the Water Co. under the agreement were de-

ductible as "rentals or other payments" within the meaning of section 23 (a) of the Revenue Acts of 1934 and 1936. Petitioner has apparently abandoned that theory, and properly so, inasmuch as title to the properties conveyed was passed to the taxpayer, whereas section 23 (a) applies only to properties to which the taxpayer has not or is not taking title or in which he has no equity. Petitioner, however, does assert that the payments to the Water Co. should be considered as analogous to the payments of Maryland and Pennsylvania ground rents, which, if the ground rent is irredeemable, should be deductible to the extent they constitute a proper business expense pursuant to the general language of section 23 (a) and without regard to the specific clause having to do with rentals. This ingenious argument is without validity. The contract does not call for the payment of ground rents. It provides for a method by which a purchase price for the property granted to petitioner may at some future time be determined if the parties should choose to do so, and, pending such determination, provides for payment to the grantors, who held all of petitioner's stock (with the exception of qualifying shares), of all of petitioner's net earnings. We are not disposed to construe such a [10] contract, executed in California by California corporations and having as its subject matter California real estate, in a way which introduces into that commonwealth the feudal relics of real property law which have happened to survive because of historical reasons

in the two states of Pennsylvania and Maryland. We are equally unwilling to draw analogies in any interpretation of the revenue laws from "distinctions spun out of the tenuosities of surviving feudal law", to use of phrase of Mr. Justice Frankfurter in his opinion in *Helvering v. Hallock*, 309 U. S. 106.

By amendment to his original petition, the taxpayer now makes the further claim that the amounts in controversy are deductible as interest payments by virtue of section 23 (b). It appears from the stipulation filed in this proceeding that the Water Co. has been held by the Bureau of Internal Revenue to be exempt under section 101 of the Revenue Acts of 1934 and 1936 from income and capital stock taxation, but petitioner has not claimed exemption under section 101 (14); nor could such a claim be sustained had it been advanced. The issue before us is whether the disputed payments must be called interest payments or distribution of profits in the nature of dividends.

Both parties to this proceeding have cited numerous cases in their briefs in support of their respective contentions. The cited cases do not lay down any comprehensive rule which may be applied in all cases; and in each proceeding of this nature it must be determined on the facts presented whether the real transaction was that of an investment in the corporation or a loan to it. *Proctor Shop, Inc.*, 30 B. T. A. 721; *affd.*, 82 Fed. (2d) 792. On this question the designation of the instrument and the terms

therein incorporated, while not to be ignored, are not conclusive. *I. Unterberg & Co.*, 2 B. T. A. 274. The real intent of the parties is to be ferreted out and for this latter purpose evidence aliunde the contract is admissible. *Proctor Shop, Inc.*, *supra*. In a majority of the cases of this nature which have come before this Board the instrument issued by the corporation has been some form of stock certificate. In the instant proceeding the provision for payment of petitioner's earnings to the Water Co. is not found on the capital stock certificates, but in the same agreement under which petitioner issued the 100 shares of capital stock to the Water Co.

The Water Co. advanced properties and property rights to the petitioner. It was not money which was advanced, but assets which had a monetary value. Had the Water Co. wanted to treat the transaction merely as a loan, with a definite annual income, in the nature of interest, from the transaction, it could have demanded a certain fixed payment from the petitioner each year until a certain fixed date, when the principal should become unconditionally due. The value of the properties transferred was, however, not agreed upon at the time of the transaction.

[11]

Let us look at petitioner's condition at the time of the transaction. It had a charter and an option to purchase certain piping, but these appear to have been its sole assets. It was desirous of securing a franchise and for this purpose needed the assets which the Water Co. transferred pursuant to the

agreement in question. It, in turn, borrowed from the bank in order to purchase and erect the building, pipe lines, etc., on the properties, and, in exchange for this loan, issued \$350,000 worth of 6 percent first mortgage bonds. The bonds were specifically secured by all the interest of petitioner in and to any of its properties held at that time, or property interests to be acquired in the future, including the benefits to be received from a 30-year lease which petitioner made with the Edison Co., under which all its properties were turned over for that term to the Edison Co.

The basic transaction was the one between the Fontana Co. and Water Co. and petitioner. Unless petitioner could have acquired some assets to start with, it would not have been able to carry out either of the other two transactions. The president and treasurer of the Water Co. and the Fontana Co. had become the president and treasurer of petitioner. To say that all three corporations were on friendly terms would be a gross understatement. The central management thought of the newly formed corporation merely as another source of profit. By the issuance of the 100 shares of capital stock (the entire issue except for the qualifying shares), the other two corporations secured control over petitioner's profits and were assured of an 8 percent annual dividend on the stock. No amount equivalent to the value of the properties transferred could have been paid in cash by petitioner at that time, inasmuch as it had neither cash nor unpledged assets;

nor could it ever be paid in the future if the Water Co. held petitioner to the terms of the agreement, because so long as the annual net income had to be paid over to the Water Co. the petitioner never could amass cash or free assets with which to repay the Water Co. at any time for the properties transferred. If there were no profits in any year, then the Water Co. and the Fontana Co. would get nothing. If the profits were enormous, then the Water Co. and the Fontana Co. would get them all. The Water Co. chose to gamble. The mere fact that the aggregate net income paid over to the Water Co. approximates in amount legal interest on the unpaid balance of a loan estimated at \$350,000 is merely coincidental. The transaction was strictly an investment from 1916 up to and including the taxable years.

As we said in *Bakers' Mutual Cooperative Association of Newark, New Jersey*, 40 B. T. A. 656; *affd.*, — Fed. —, C. C. A., 3d Cir., Jan. 7, 1941:

* * * a creditor is one who has loaned money or its equivalent to his debtor, the contract giving the creditor not only the unconditional right to de- [12] mand payment of the principal sum at a definite maturity date, but usually, also, the right to demand, and receive, compensation for its use or retention, i. e., interest. A stockholder, on the other hand, is one who risks his money in an enterprise, participates in its profits and management, shares its losses, and is entitled to receive an aliquot portion of its

assets in the event of liquidation. Northern Fire Apparatus Co., 11 B. T. A. 355; Elko Lamoille Power Co., 21 B. T. A. 291; *affd.*, 50 Fed. (2d) 595.

It may be true that the agreement of 1916 indicated a possibility of the creation of a debtor-creditor relationship and the method to be followed if such a relationship were to be created in the future, but the mere existence of this possibility, which was never fulfilled, can not affect our conclusion that, in reality, during the years in question the relationship of the Water Co. to petitioner was that of an investor and not that of a creditor.

Certain other factors lend further weight to this conclusion. From the facts it appears that in all the years from 1917 until the present time there was no attempt made to agree on a valuation of the properties and thus carry out that clause of the agreement and the order of the Railroad Commission of California which provided for payment of principal. We must assume that the reason for this was that, since the Water Co. during the years in question was the sole stockholder, that company and the petitioner were satisfied with an arrangement whereby all the profits went to the Water Co. under the agreement, and were not interested in creating any debtor-creditor relationship.

That part of petitioner's argument to the effect that the annual payments by petitioner were payments of interest which is based upon a supposed analogy to Pennsylvania and Maryland ground rents

is no more convincing than its argument based on the same analogy to the effect that these payments were ordinary and necessary business expenses, the fallacy of which we have already discussed.

Neither are we impressed by petitioner's argument that the payments involved here, made by petitioner to its stockholders for so many years, can not be considered as distributions in the nature of dividends because (1) they were made pursuant to a contract and not pursuant to the rights of the payees as stockholders, and (2) the distributions consisted of the net earnings and not the surplus profits technically available for dividends. We are persuaded that the contract was executed and the distributions were made for so many years pursuant thereto because the Fontana Co. and/or the Water Co. were the holders of all of the stock of petitioner (except qualifying shares). It was because of this latter fact that the arrangement proved so permanently satisfactory to petitioner's controlling stockholders, and if we are to recognize the realities we must conclude that the ultimate reason for the distributions made to the Fontana Co. and/or the [13] Water Co. was because, for all practical purposes, they were the sole stockholders of petitioner. As to them, by the peculiar arrangement present in this proceeding, it made little difference whether the distribution consisted of petitioner's net earnings or surplus profits. By the contract which they imposed on their wholly owned subsidiary they were entitled to the former. Without the contract they would have been entitled

to the latter. The amount to be received by them would be the same. The practical effect of the transactions was to distribute an amount equivalent to the net profits of petitioner to its stockholders.

We conclude that the payments made by petitioner to the Water Co. according to the agreement in the taxable years were distributions in the nature of dividends, and, accordingly, were not payments of interest, or ordinary and necessary business expenses.

Decision will be entered for the respondent. [14]

EXHIBIT 1A

United States Board of Tax Appeals
Washington

Docket No. 99767

FONTANA POWER COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion, promulgated March 21, 1941, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1935, 1936 and 1937 in the respective amounts of \$2,536.66, \$1,758.22, and

\$3,130.50, and deficiencies in excess profits tax for said years in the respective amounts of \$922.42, \$189.87 and \$2,787.58.

Enter:

Entered March 29, 1941.

(Board of Tax Appeals)

(U. S. 1924)

(Seal)

JOHN W. KERN,

Member [15]

EXHIBIT 2

United States Circuit Court of Appeals
For the Ninth Circuit

[Title of Cause.]

PETITION FOR REVIEW OF DECISION OF THE BOARD OF TAX APPEALS

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The petition of Fontana Power Company, a corporation organized under the laws of the State of California, and having its principal office at Fontana, California, respectfully shows:

1. This is a proceeding for review by the United States Circuit Court of Appeals for the Ninth Circuit, of a decision of the United States Board of Tax Appeals, entered on March 29, 1941, redetermining deficiencies in income taxes and excess profits taxes of petitioner for the taxable years of 1935, 1936 and 1937, in the aggregate amount of

\$11,325.25, of which amount \$11,294.07 was in dispute. [16]

2. Petitioner filed income tax returns for said years of 1935, 1936 and 1937 with the Collector of Internal Revenue of Los Angeles, California. The office of said Collector is within the Ninth Circuit.

3. The nature of the controversy before the Board of Tax Appeals was the determination of income and excess profits taxes of petitioner for the years of 1935, 1936 and 1937, and in particular whether certain payments made by petitioner during each of said years, pursuant to or under a contract made by petitioner, were deductible from gross income in the determination of net taxable income.

Petitioner contended before said Board of Tax Appeals, and now contends, that said payments were deductible from petitioner's gross income.

(a) as interest, pursuant to the provisions of section 23 (b) of the Internal Revenue Code; and,

(b) as ordinary and necessary expenses of petitioner's business, pursuant to the provisions of Section 23 (a) of said Internal Revenue Code.

Said Board of Tax Appeals held that said payments were in the nature of dividends or distributions of income, and were not deductible from petitioner's gross income.

Wherefore, your petitioner prays this Honorable Court to review the action of the Board of Tax Appeals in this cause and reverse the decision of said Board and direct [17] the entry of the decision

of said Board in favor of petitioner, determining that said payments are allowable deductions and determining petitioner's tax liability accordingly.

GEO. W. HELLYER

JOHN B. SURR

Attorneys for Petitioner,
204 Citizens National Bank Bldg.,
San Bernardino, California.

State of California,
County of San Bernardino.—ss.

J. D. McGregor, being first duly sworn, says: that he is an officer, to wit, the Secretary of Fontana Power Company, the petitioner named in and that makes the above and foregoing petition; that he has read said petition and knows the contents thereof and that the same is true of his own knowledge, except as to the matters therein alleged upon information or belief, and as to such, he believes it to be true.

J. D. MCGREGOR

Subscribed and sworn to before me this 16th day of June, 1941.

(Notarial Seal)

P. McLARNAN,
Notary Public in and for said
County and State.

[Endorsed]: U. S. B. T. A. Filed July 10, 1941.

[18]

EXHIBIT 3

(SUPPLEMENTAL APPLICATION TO
RAILROAD COMMISSION)

To the Honorable the Railroad Commission of the
State of California.

This Amendment to Application of Fontana
Power Company, Fontana Union Water Company
and Fontana Company respectfully shows:

I.

In the above entitled Application, heretofore filed
with the Railroad Commission, Fontana Power
Company, Fontana Union Water Company and
Fontana Company submitted for the approval of
the Railroad Commission the proposed purchase by
Fontana Power Company from Fontana Union
Water Company and Fontana Company of a power
house site, rights of way and rights to use certain
waters of Lytle Creek in San Bernardino County,
California, for the total consideration of three hun-
dred and forty-nine thousand, five hundred dollars
(\$349,500), to be paid by Fontana Power Company
to Fontana Union Water Company and Fontana
Company, the description of the property so to be
purchased and the terms of payment therefor being
set forth in full in a copy of a certain option agree-
ment attached to said Application and marked "Ex-
hibit C" and made a part thereof.

II.

It now appears impossible to prepare and submit
to the Railroad Commission, at the present time,

data sufficient to enable the Railroad Commission to fix the value and approve the [19] purchase price of said properties so proposed to be conveyed by Fontana Union Water Company and Fontana Company to Fontana Power Company.

III.

Fontana Power Company has acquired an option until October 6th, 1916, for the purchase of such steel required for the pressure pipe forming part of the hydro-electric system proposed to be constructed by Fontana Power Company, as set forth in the above-entitled Application, and if said option is not exercised on or before October 6th, 1916, the cost of such steel will be greatly increased.

IV.

Fontana Power Company, Fontana Union Water Company and Fontana Company, in order to prevent the loss of such valuable steel contract, and to provide further time within which data may be furnished to and considered by the Railroad Commission for the fixing of the value and approval of the purchase price of the properties so to be conveyed by Fontana Union Water Company and Fontana Company to Fontana Power Company, now propose, subject to the approval of the Railroad Commission, to enter into an agreement in such form as the Railroad Commission hereafter shall approve, providing for the immediate conveyance by Fontana Union Water Company and Fontana Company to Fontana Power Company of all

the properties described in said option agreement, for the consideration of (a) one hundred (100) shares of the capital stock of Fontana Power Company, to be issued and delivered to Fontana Union Water Company and Fontana Company, or their nominees, upon the execution and delivery by them of a proper conveyance or con- [20] veyances of said property, (b) the covenant of Fontana Power Company to pay to Fontana Union Water Company and Fontana Company the difference between the value of said shares and the value of the properties so to be conveyed as soon as the value of said properties and the method of payment therefor can be agreed upon between Fontana Union Water Company, Fontana Company and Fontana Power Company and approved by the Railroad Commission, or in such other manner as may be required by law, and (c) the further covenant of Fontana Power Company that, pending the fixing of said value and the making of payment therefor, Fontana Power Company, from time to time, will pay over to Fontana Union Water Company and Fontana Company all its earnings remaining after paying or providing for payment of its operating expenses (including depreciation), taxes and interest and all obligations it may have incurred or for which it may have become responsible, and, in the event of sale of all or any portion of its properties, it will pay over to Fontana Union Water Company and Fontana Company the entire proceeds remaining from such sale, after paying or providing for the pay-

ments of its indebtedness and all expenses and obligations it may have incurred or for which in any way it may have become responsible.

Wherefore, Fontana Power Company, Fontana Union Water Company and Fontana Company pray for the following relief:

(a) For permission for Fontana Power Company to issue to Fontana Union Water Company and Fontana Company one hundred (100) shares of the capital stock of Fontana Power Company as part payment for the properties above described.

[21]

(b) For permission for Fontana Power Company to execute with Fontana Union Water Company and Fontana Company an agreement for the payment of the remainder of the purchase price of said properties when the value thereof can be determined in the manner above set forth and for the payment in the meantime of the surplus earnings of said properties and the net proceeds of any sale thereof, all as above described.

(Duly verified.) [22]

EXHIBIT 4.

(Excerpts from Decision No. 3773 of Railroad Commission of California, Dated October 10, 1916)

“ In addition, Fontana Power Company proposed to issue 100 shares of its stock of the par value of \$100 per share to Fontana Union Water

Company and Fontana Company as part payment for a power house site, rights of way and rights to use certain waters of Lytle Creek, in San Bernardino County.

The transaction involving the transfer of these properties by Fontana Union Water Company and Fontana Company to Fontana Power Company will be covered by an agreement, under the terms of which Fontana Power Company will deliver the \$10,000, par value of stock, and will further covenant:

1. To pay to Fontana Union Water Company and Fontana Company the difference, if any, between the value of said \$10,000 of stock and the value of the properties so to be conveyed, as soon as the value of the said properties and the method of payment therefor can be agreed upon between the parties and approved by the Railroad Commission.

2. To pay to Fontana Union Water Company and Fontana Company, pending the fixing of the value of the properties conveyed, all its profits from the business after meeting all necessary charges; and in case of sale, the proceeds remaining after paying its obligations.

This arrangement has been entered into because no definite value has at this time been fixed for the properties to be transferred to Fontana Power Company and request is made to issue \$10,000 of par value stock in the form of first payment."

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“It is hereby ordered that Fontana Power Company be granted authority, and it is hereby granted authority, to issue one hundred (100) shares of its capital stock of the par value of One Hundred Dollars (\$100) per share to Fontana Union Water Company and Fontana Company as part payment for a power house site, rights of way and rights to use certain waters of Lytle Creek, in San Bernardino County;” [23]

* * * * *

“It is further ordered that Fontana Power Company be granted authority to enter into a contract with Fontana Union Water Company and Fontana Company, under the terms of which Fontana Union Water Company and Fontana Company shall convey to Fontana Power Company, a power house site, rights of way and rights to use certain waters of Lytle Creek, in San Bernardino County, for the following consideration:

(a) One hundred (100) shares of the capital stock of Fontana Power Company, to be issued and delivered to Fontana Union Water Company and Fontana Company, or their nominees, upon the execution and delivery by them of a proper conveyance or conveyances of said properties, (b) the covenant of Fontana Power Company to pay to Fontana Union Water Company and Fontana Company the difference between the value of said shares and the value of said properties and the method of payment

therefor can be agreed upon between Fontana Union Water Company, Fontana Company and Fontana Power Company and approved by the Railroad Commission, or in such other manner as may be required by law, and, (c) the further covenant of Fontana Power Company to pay to Fontana Union Water Company and Fontana Company, pending the fixing of the value of the properties conveyed, all its profits from the business after meeting all necessary charges; and in case of sale, the proceeds remaining after paying its obligations; provision to be made for the prior rights attaching to the ownership of stock of Fontana Power Company.

The authority to enter into said contract is conditioned upon the approval by the Railroad Commission of a copy of said contract to be hereafter filed by Fontana Power Company." [24]

EXHIBIT 5

This agreement, made this 30 day of January, 1917, between Fontana Company and Fontana Union Water Company, both corporations organized and existing under the laws of the State of California, parties of the first part, and Fontana Power Company, a Corporation organized and existing under the laws of the State of California, party of the second part.

Witnesseth:

Whereas, the party of the second part desires to acquire from the party of the first part certain valuable properties, easements and rights respectively described in the drafts of two indentures hereunto attached and respectively marked Exhibit "A" and Exhibit "B" and

Whereas, it is not possible at this time to fix the definite value of the properties, easements and rights so to be acquired by the party of the second part from the parties of the first part, and to secure the approval of such value by the Railroad Commission of the State of California; and

Whereas, it is necessary that construction be begun immediately upon the power plant and hydro-electric system proposed to be constructed by the party of the second part upon the real property forming part of the property so to be acquired by the party of the second part; and

Whereas, the purchase by the party of the second part from the parties of the first part of the properties, easements and rights described in said two indentures hereunto annexed and the form of this agreement have been approved by the Railroad Commission of the State of California, in its decision No. 3773, made and [25] entered on the 10th day of October, 1916;

Now, therefore, in consideration of the mutual covenants hereinafter expressed, the parties hereto do agree as follows:

First: The parties of the first part agree forthwith to execute, acknowledge and deliver unto the party of the second part two indentures substantially in the form of the drafts of indentures hereunto annexed and respectively marked Exhibit "A" and Exhibit "B" conveying and assigning to the party of the second part all the properties, easements and rights in such indentures described.

Second: The party of the second part, upon the execution and delivery to it by the parties of the first part of such indentures, and as part consideration for the properties, rights and easements thereby conveyed, agrees to [issue to said Fontana Company a certificate of stock representing fifty (50) fully paid shares of the capital stock of said party of the second part, and to issue and deliver to said Fontana Union Water Company a certificate representing fifty (50) fully paid shares of the capital stock of the party of the second part.]

Third: The party of the second part further agrees to [pay to said Fontana Company and Fontana Union Water Company, one-half to each, the difference between the value of said one hundred (100) shares of the Capital Stock of the party of the second part and the value of the properties so to be conveyed by the parties of the first part to the party of the second part, as soon as the value of said properties and the method of payment therefore can be agreed upon between the parties of the first part and the party of the second part, and approved by the Railroad Commission of the [26]

State of California, or fixed in some other manner in accordance with law.]

Fourth: The party of the second part further agrees, pending the fixing of the value of the properties so to be conveyed, and the payment of the remainder of the purchase price thereof, as aforesaid, to pay to said Fontana Company and Fontana Union Water Company, one-half to each, all profits realized from the business of the party of the second part after paying all its operating expenses (including depreciation), taxes, interest, all obligations which it may incur or for which it may become responsible, and dividends of not exceeding eight per cent (8%) per annum, upon its outstanding capital stock.]

Fifth: The party of the second part further agrees that in the event that its properties, easements or rights are sold before the value of the properties, easements and rights acquired by it from the parties of the first part has been fixed and paid as aforesaid, the party of the second part will pay to said Fontana Company and Fontana Union Water Company, one-half to each, the entire proceeds of such sale or sales remaining after paying or providing for the payment of the indebtedness, expenses and all obligations of the party of the second part and setting aside for the benefit of its stockholders an amount equal to the par value of its outstanding capital stock.

In witness whereof, the parties hereto, on the day and year first above written, have hereunto

caused their corporate names to be subscribed and their corporate seals to be affixed by [27] their respective officers thereunto duly authorized by resolution duly and regularly adopted by their respective Boards of Directors.

FONTANA COMPANY,

By A. B. MILLER,

President

By RAY H. BASSLER,

Secretary

FONTANA UNION WATER
COMPANY,

By A. B. MILLER,

President

By RAY H. BASSLER,

Secretary

FONTANA POWER COMPANY,

By A. B. MILLER,

President

By RAY H. BASSLER,

Secretary. [28]

EXHIBIT 6

Decision No. 4376.

Before the Railroad Commission of the
State of California

Application No. 2245.

In the Matter of the Application of FONTANA POWER COMPANY for a certificate of public convenience and necessity, for permission to issue stock and bonds and to mortgage property to secure said bonds, and for permission to enter into a certain indenture of lease.

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY, a corporation, for authority to enter into a certain indenture of lease and to enter into a certain contract for the sale of power.

In the Matter of the Application of RIALTO DOMESTIC WATER COMPANY, a corporation, to enter into a certain contract for the purchase of power.

By the Commission.

Third Supplemental Order

Whereas this Commission in Decision Number 3773, dated October 10, 1916, authorized Fontana Power Company and Southern California Edison Company to enter into a contract for lease of property and purchase and sale of electric power, in the form of a [29] copy of said contract filed with this Commission as Exhibit "1"; and

Whereas this Commission further authorized Fontana Power Company to enter into a contract with Fontana Union Water Company and Fontana Company for the transfer of certain property, said authority being conditioned upon the approval of a copy of said contract by this Commission; and

Whereas Fontana Power Company has now advised this Commission that the contract between Fontana Power Company and Southern California Edison Company, as finally executed differed in certain minor particulars from the form of contract approved by this Commission in Decision Number 3773, and has filed for the Commission's approval a copy of said contract as finally executed; and

Whereas Fontana Power Company has also filed for this Commission's approval a copy of the proposed contract to be entered into between Fontana Power Company, Fontana Union Water Company and Fontana Company, covering the transfer of certain property;

And it appearing to this Commission that the contract between Southern California Edison Company and Fontana Power Company should be approved and that Fontana Power Company should be authorized to enter into a contract with Fontana Union Water Company and Fontana Company, covering the transfer of certain property;

It is hereby ordered that the contract dated January 18, 1917, between Fontana Power Company and Southern California Edison Company be and the same is hereby approved, a copy of said contract

being on file herein, marked "Exhibit 1 amended".

[30]

The approval of the contract between Fontana Power Company and Southern California Edison Company is given on the condition that the Railroad Commission reserves the right hereafter to issue such orders as it may find necessary, which may modify or affect the terms of the lease set forth in said contract, or the terms and conditions of the interchange of electric power as set forth in said contract.

It is hereby further ordered that Fontana Power Company be and it is hereby authorized to enter into a contract with Fontana Company and Fontana Union Water Company substantially in the form of a contract filed with this Commission on February 23, 1917, and marked Exhibit "11";

The approval herein given of said contracts is for the purpose of this proceeding only and is an approval only in so far as this Commission has jurisdiction under the terms of the Public Utilities Act, and is not intended as an approval of said contracts as to such other legal requirements to which said contracts may be subject.

Dated at San Francisco, California, this 6th day of June, 1917.

MAX THELEN

H. D. LOVELAND

ALEX GORDON

EDWIN O. EDGERTON

Commissioners.

[Endorsed]: U.S.B.T.A. Filed Aug. 5, 1941. [31]

United States Board of Tax Appeals

Washington

Docket No. 99767

FONTANA POWER COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 31, inclusive, contain the record on appeal as agreed to by the parties in accordance with Rule 76 of the Rules of Civil Procedure for the District Courts of the United States.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 12th day of August, 1941.

(Seal)

B. D. GAMBLE,

Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 9901. United States Circuit Court of Appeals for the Ninth Circuit. Fontana Power Company, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed August 27, 1941.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 9901

FONTANA POWER COMPANY,

Appellant.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

STATEMENT OF POINTS RELIED UPON BY
APPELLANT ON APPEAL AND DESIGNATION OF PARTS OF RECORD NECESSARY.

On appeal to the United States Circuit Court of Appeals for the Ninth Circuit, from a decision of the United States Board of Tax Appeals (herein-

after called "Board"), entered March 29, 1941, appellant, Fontana Power Company, intends to rely, and relies, on the following points:

1. Said decision is contrary to law in that thereby income taxes and excess profits taxes for the years 1935, 1936, and 1937, are imposed upon amounts in excess of appellant's net taxable income for said years, respectively, such excessive amounts corresponding with and being equal to payments made by appellant to Fontana Union Water Company, as follows:

For 1935, the sum of \$18,262.39;

For 1936, the sum of \$16,244.55;

For 1937, the sum of \$27,000.00.

2. Said Board erred in holding that said payments of \$18,262.39, \$16,244.55 and \$27,000.00 were not deductible from appellant's gross income for the respective years paid.

3. Said Board erred in holding said payments were distributions in the nature of dividends.

4. Said Board erred in holding said payments were not interest.

5. Said Board erred in holding said payments were not ordinary and necessary business expenses.

DESIGNATION OF PARTS OF RECORD

Appellant hereby designates as necessary for consideration of the points relied upon, the entire transcript as certified by the Clerk of the Board and filed with the Clerk of the above named Court. The Clerk of the above named Court is requested and

directed to cause said transcript to be printed in its entirety.

Dated: September 2, 1941.

GEO. W. HELLYER,
JOHN B. SURR,
Counsel for Appellant.

AFFIDAVIT OF SERVICE BY MAIL

State of California

County of San Bernardino—ss.

P. McLarnan, being first duly sworn, says:

I am a citizen of the United States of America, over the age of eighteen years, a resident of the above named County and State, and not a party to the action named in the title of the annexed document. My business address is Suite 204 Citizens National Bank Building, San Bernardino, California.

On the date of mailing shown below I deposited in the United States mail at San Bernardino, California, at the request of Surr & Hellyer, a sealed envelope (postage prepaid) which contained a true copy of each annexed document, and which envelope was addressed to the office address of the addressee, as follows:

Date of mailing:—September 2, 1941

Document mailed:—Statement of Points and Designation of Record.

Name and address:—J. P. Wenchel, Esq., Chief Counsel, Bureau of Internal Revenue, Washington, D. C.; attention R. L. Williams, Esq.

At the time of said mailing there was regular communication by mail between the place of mailing and the place so addressed.

P. McLARNAN

Subscribed and sworn to before me this 2d day of September, 1941.

(Seal) F. A. LEONARD, JR.,

Notary Public in and for the County of San Bernardino, State of California.

[Endorsed]: Filed Sept. 4, 1941. Paul P. O'Brien, Clerk.

No. 9901.

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

FONTANA POWER COMPANY, a corporation,
Petitioner and Appellant,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee.

APPELLANT'S OPENING BRIEF.

GEO. W. HELLYER,
JOHN B. SURR,
of SURR & HELLYER,
204 Citizens National Bank Building,
San Bernardino, California,
Counsel for Appellant.

FILED

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PAUL W. O'BRIEN,



TOPICAL INDEX.

	PAGE
Record on appeal.....	1
Jurisdiction	2
Statement of the case.....	2
Specification of errors.....	9
Argument	10

I.

The payments in dispute were made to Water Company as creditor and not as stockholder.....	10
A. Provisions and nature of the agreement under which the payments were made.....	10
B. Payments were not net proceeds.....	12
C. The rights and relations of the parties are to be determined by the provisions of the agreement and the attending circumstances	15
D. Payments were not attributable to any rights of Water Company as holder of issued shares.....	17
E. Appellant could not issue stock or long-term evidences of indebtedness without approval of Railroad Commission	19
F. Appellant could not have created a stock interest with rights like those created by the agreement.....	20
G. An obligation to pay, when enforceable by the obligee, establishes the relation of debtor-creditor.....	23
H. The reasons advanced by the Board are not well founded	26

II.

The payments involved constituted interest.....	30
---	----

III.

The payments were deductible as ordinary and necessary expenses of business.....	33
Conclusion	35

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Arthur R. Jones Syndicate v. Commissioner, 23 Fed. (2d) 833	23, 25
Buffalo Eagle Mines, Inc. v. Commissioner, 37 B. T. A. 843.....	34
Canfield Lumber Company v. Commissioner, B. T. A. memo, June 7, 1940.....	34
Commissioner v. John C. Moore Corp., 42 Fed. (2d) 186.....	32
Commissioner v. Palmer, Stacy-Merrill, Inc., 111 Fed. (2d) 809	23
Commissioner v. Proctor Shop, Inc., 82 Fed. (2d) 792.....	23, 24, 25
Del Monte L. & P. Co. v. Jordan, 196 Cal. 488, 238 Pac. 710....	21
Fall River Electric Light Company v. Commissioner, 23 B. T. A. 168	30
Fidelity Savings and Loan Association v. Commissioner, 23 B. T. A. 1059.....	29
General Film Corporation, In re, 274 Fed. 903.....	34
George La Monte & Son v. Commissioner, 32 Fed. (2d) 220....	34
Helvering v. Richmond, F. & P. R. Co., 90 Fed. (2d) 971.....	32
Kena, Inc. v. Commissioner, 44 B. T. A. 39.....	30
Land Development Company v. Jordan, 198 Cal. 346, 245 Pac. 187	21
Nehi Bottling Company, B. T. A. memo, Docket No. 102054, May 27, 1941.....	34
Uniform Printing and Supply Company v. Commissioner, 88 Fed. (2d) 75, 109 A. L. R. 966.....	19
Wiggin Terminals, Inc. v. United States, 36 Fed. (2d) 893.....	32

STATUTES.

PAGE

California Constitution, Art. XII, Sec. 3.....	21
California Constitution, Art. XII, Sec. 12.....	21
Civil Code, Sec. 290.....	21
Civil Code, Sec. 326.....	21
Internal Revenue Code, Sec. 1141, para. (a).....	2
Internal Revenue Code, Sec. 1141, para. (b) (1).....	2
Public Utilities Act of California, Sec. 42(b).....	19
Public Utilities Act of California, Sec. 52(a) (Cal. Stats. 1915, p. 115)	19
Public Utilities Act of California, Sec. 52(b).....	20
Revenue Act of 1934, Sec. 23(a).....	33
Revenue Act of 1934, Sec. 23(b).....	30
Revenue Acts of 1934 and 1936, Sec. 101.....	3
Revenue Act of 1936, Sec. 23(a).....	33
Revenue Act of 1936, Sec. 23(b).....	30
Rules of Civil Procedure, Rule 76.....	1, 2
Treasury Regulations, 103, Sec. 19.23 (b)-1.....	32

TEXTBOOKS AND ENCYCLOPEDIAS.

Abbott's Law Dictionary.....	30
11 American and English Encyclopedia of Law, 379.....	30
6a California Jurisprudence, p. 362.....	21
13 Corpus Juris 539.....	22
33 Corpus Juris 178.....	30
66 Corpus Juris 136.....	30
66 Corpus Juris 212.....	30
4 Words & Phrases, p. 3708.....	30

No. 9901.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

FONTANA POWER COMPANY, a corporation,

Petitioner and Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellee.

APPELLANT'S OPENING BRIEF.

Record on Appeal.

This proceeding is to review a decision of the United States Board of Tax Appeals, hereinafter called "Board". The record on appeal consists of an agreed statement of the case under rule 76 of the Rules of Civil Procedure. The agreed statement is printed in full in the transcript, which latter is hereinafter referred to by the letter "T", and its pages by their numbers. Thus, "T 7" refers to page 7 of said transcript. Incorporated in the transcript are the findings of fact and opinion of the Board [T 21]. The facts found or stated in said findings were incorporated in and adopted as a part of such agreed statement with the proviso that any statement in said findings in conflict with any other fact or statement incorporated in the agreed statement should give way to and be controlled by such other fact or statement.

Jurisdiction.

Appellant filed income tax returns for the calendar years of 1935, 1936 and 1937 with Collector of Internal Revenue at Los Angeles, California. The office of said Collector is within the Ninth Circuit [T 23]. Thereafter, the Commissioner of Internal Revenue determined deficiencies in appellant's income tax and excess profits taxes for said years [T 1]. Appellant petitioned the United States Board of Tax Appeals to redetermine such deficiencies. Thereafter, said Board entered its decision redetermining deficiencies in the same manner as did the Commissioner [T 21]. Thereafter, appellant filed with said Board a petition for review of said decision by this court [T 2]. A copy of said petition is incorporated in the agreed statement of case under said rule 76 [T 22]. Jurisdiction to review said decision is conferred upon this Court by paragraph (a) of section 1141 of the Internal Revenue Code, reading "The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board", and by paragraph (b)(1) of said section 1141, stating "such decisions may be reviewed by the Circuit Court of Appeals for the circuit in which is located the collector's office to which was made the return of tax in respect of which the liability arises."

Statement of the Case.

The sole question involved on this appeal is whether certain payments made by appellant to Fontana Union Water Company (hereinafter called "Water Company"), under an agreement of date January 30, 1917 [T 31] were deductible from appellant's gross income.

In its findings of fact and opinion [T 7-21], the Board referred to these payments as being appellant's net income

or net profits. The agreement required payment of appellant's net profits over amounts required for dividends and all of appellant's obligations. Except for the erroneous statement in this particular, the Board's findings of fact constitute a fair statement of the case. Such findings are here repeated in full and the same constitute all of this statement, with the exception of the last paragraph hereof.

FINDINGS OF FACT.

The parties have fully stipulated the facts in this proceeding, and, as stipulated, we have adopted those facts, which are materially as follows:

The Fontana Power Co., petitioner herein, was incorporated under the laws of the State of California on or about April 3, 1916, and at all times since has functioned as a public utility corporation, subject to the jurisdiction of and regulation by the Railroad Commission of the State of California. Its principal place of business is at Fontana, California.

The Fontana Union Water Co., hereinafter called the Water Co., was incorporated in 1912 under the laws of the State of California as a mutual water company for the irrigation of farm lands in the vicinity of the town of Fontana. The Water Co. has been held by the Bureau of Internal Revenue to be exempt under section 101 of the Revenue Acts of 1934 and 1936 from income and capital stock taxation.

The Fontana Co. was incorporated under California law prior to petitioner, and continued to be so incorporated until it was dissolved in 1927.

A. B. Miller was president of all three corporations.

Prior to August 9, 1916, the petitioner made application to the Railroad Commission of California for a certificate that public convenience and necessity require the construction of an electrical power plant and system near the town of Rialto; and for leave, *inter alia*, to execute a mortgage on its properties and to issue thereunder \$350,000 face value of first mortgage 6 percent bonds, and for leave to acquire from the Water Co. and the Fontana Co. certain properties and property rights. Thereafter, prior to October 10, 1916, petitioner filed with the commission a supplemental application reciting that it appeared impossible at that time to prepare and submit to the commission data sufficient to enable the commission to fix the value and approve the purchase price of the properties proposed to be conveyed by the Water Co. and the Fontana Co. to petitioner. The application stated that petitioner had an option to purchase certain steel required for use in construction of its proposed pressure pipes, which option would expire October 6, 1916, after which time the price of steel would be considerably higher due to the wartime market. In order to prevent the loss of this steel contract and allow further time in which to prepare data for the commission respecting the fixing of the value and approval of the purchase price of the properties, it was proposed to enter into an agreement providing for the immediate conveyance of the properties to petitioner for the consideration of: (1) 100 shares of capital stock in the petitioner corporation; (2) petitioner's covenant to pay the Water Co. and the Fontana Co. the difference between the value of the 100 shares and the value of the properties so to be conveyed as soon as the value and the method of payment could be agreed upon between the three corporations and approved by the

commission; and (3) the further covenant of petitioner that, pending the fixing of the value and making of payment, the petitioner, from time to time, would pay over to the Water Co. and the Fontana Co. all its earnings remaining after paying or providing for payment of its operating expenses, taxes, and interest and all obligations it might have incurred or for which it might have become responsible.

Thereafter, on October 10, 1916, the Railroad Commission of California made and rendered its decision granting petitioner authority to issue the 100 shares of capital stock of the par value of \$100 per share as part payment to the Water Co. and the Fontana Co. for a powerhouse site and certain property rights and to issue the \$350,000 of its first mortgage 6 percent bonds upon certain conditions, and granting authority to petitioner to enter into the proposed contract with the Water Co. and the Fontana Co. on the proposed terms, conditioned upon the approval by the commission of a copy of the contract to be thereafter filed by petitioner. The commission also declared that public convenience and necessity required the construction by petitioner of the proposed hydroelectric power plant and system.

Thereafter, on January 30, 1917, the Railroad Commission of California issued a supplemental order approving the mortgage and trust deed, which approval was the condition precedent to the issuance of the mortgage bonds. The supplemental order recited that the \$350,000 6 percent mortgage bonds were to be secured by a mortgage upon all the property then owned or thereafter to be acquired by petitioner.

On February 6, 1917, the Railroad Commission of California issued a second supplemental order, reapproving

the mortgage and trust deed in slightly amended forms. Thereafter, on June 6, 1917, the commission, by its third supplemental order, authorized petitioner to enter into a contract with the Water Co. and the Fontana Co. substantially in the form of the contract as filed with the commission on February 23, 1917, which contract has heretofore been set out in substance.

Thereafter, on June 15, 1917, petitioner entered into the contract with the Water Co. and the Fontana Co. and the latter two corporations conveyed the properties and rights to the petitioner. Pursuant to the commission's order petitioner also executed the trust indenture, and bonds of petitioner in the amount of \$350,000 were issued and sold under the indenture, and the proceeds were used in the development of petitioner's property. The properties and rights acquired from the Water Co. and the Fontana Co. were leased by petitioner to the Southern California Edison Co. for 30 years, commencing July 1, 1917, and were mortgaged by petitioner under the trust indenture to secure its bond issue.

When petitioner was incorporated, 5 qualifying shares were issued. Thereafter, pursuant to the commission's order authorizing the contractual agreement with the Water Co. and the Fontana Co., petitioner issued to the Fontana Co. 50 shares of stock and a like number to the Water Co. In 1927 the Water Co. acquired the 50 shares originally issued to the Fontana Co., and also acquired all interests and rights originally acquired and owned by the Fontana Co. under the agreement; and at all times since the Water Co. has been, and still is, the owner of the 100 shares of stock and of all rights originally acquired by the Fontana Co. and the Water Co. in and under the agreement. These 105 shares of stock are the only

shares of petitioner corporation which have ever been issued.

During the year 1937 the Water Co. and the petitioner executed an agreement for the purpose of construing and resolving the meaning of certain provisions of the original agreement. By this 1937 agreement petitioner was allowed to deduct from its gross income, when calculating net income for the purposes of the original agreement, all charges for discount of its outstanding bonds and any expense in connection therewith. By order of October 25, 1937, the Railroad Commission of California approved this interpretation of the agreement.

During the year 1917, petitioner constructed the proposed hydroelectric plant on the powerhouse site, and also constructed pipe lines along the right of way conveyed to it by the Water Co. and the Fontana Co. Aside from income arising out of its business, petitioner never acquired any property of substantial value other than that conveyed to it by the deeds from the Water Co. and the Fontana Co., and the improvements acquired with the proceeds from the sale of the bonds.

Commencing July 1, 1917, and at all times since its construction, the plant has been operated by the Edison Co. under the lease whereby petitioner reserved and receives electricity generated in said plant for supplying its customers, and the Edison Co. pays a rental determined by and based upon the excess power generated in the hydroelectric plant. At all times since the plant's erection the only business of petitioner has consisted of supplying its customers in the Fontana territory with electric power, either generated at its plant, or, in the case of a deficiency for its requirements, purchased and received by petitioner from the Edison Co.

The amounts claimed by petitioners as deductions from gross income, which amounts were disallowed by respondent (being \$18,262.39, \$16,244.55, and \$27,000 for the years 1935, 1936, and 1937, respectively), were paid by petitioner to Water Co. pursuant to that provision of the agreement between the corporations calling for the payment of all annual net income.

The value of the properties and rights conveyed to petitioner by the Water Co. and the Fontana Co. has not yet been fixed, and the method of payment of the remainder of the purchase price thereof has not yet been determined, and, since the commencement of petitioner's operations in 1917, all of its net income in excess of operating and other expenses and an 8 percent dividend on its outstanding capital stock has been paid to the Water Co. and the Fontana Co., pursuant to the agreement between the three corporations.

No orders have been issued by the Railroad Commission of California bearing on the valuation of the properties conveyed to petitioner or bearing on the agreement between the three corporations or the lease to the Southern California Edison Co. or the trust indenture or the bonds issued thereunder other than the orders mentioned above.

No attempt has at any time been made by petitioner to fix the value of the properties conveyed to it or to secure the approval of the Railroad Commission of California to the fixing of that value other than the mention of the value of \$349,500 in the amended application of petitioner to the commission in October, 1916. Petitioner has never made any of the payments provided for in the agreement other than to issue the 100 shares of stock and the payments of income, as per agreement, as set out above.

In its annual reports to the Railroad Commission of California and in its Federal tax returns from 1917 to date, petitioner has deducted from its gross income the payments made by it pursuant to the agreement with the Water Co. and the Fontana Co. (End of Findings.)

In its tax returns for 1935, 1936 and 1937, appellant deducted from gross income said amounts paid Water Company. The Commissioner disallowed said payments and solely as a result of such disallowance determined deficiencies in appellant's income taxes in the amounts of \$2,536.66, \$1,758.22 and \$3,130.50, respectively, for those years; and deficiencies in excess profits tax in the amounts of \$922.42, \$189.87 and \$2,787.58, respectively [T 1, 6]. In its decision the Board sustained the Commissioner and held the deficiencies to be as determined by the Commissioner [T 21].

Specification of Errors.

1. The Board erred in holding that the payments by appellant to Water Company for the years 1935, 1936 and 1937 in the amounts of \$18,262.39, \$16,244.55 and \$27,000, respectively, were not deductible from appellant's gross income for the respective years paid.

2. The Board erred in holding said payments were distributions in the nature of dividends.

3. The Board erred in holding said payments were not deductible as interest.

4. The Board erred in holding said payments were not deductible as ordinary and necessary expenses of appellant's business.

I.

The Payments in Dispute Were Made to Water Company as Creditor and Not as Shareholder.

A. PROVISIONS AND NATURE OF AGREEMENT UNDER WHICH PAYMENTS WERE MADE.

In the agreement, appellant was referred to as the party of the second part. The agreement [T 32, 33] recites and provides:

"Whereas, it is not possible at this time to fix the definite value of the properties, easements and rights so to be acquired by the party of the second part from the parties of the first part, and to secure the approval of such value by the Railroad Commission of the State of California; and

Whereas, it is necessary that construction be begun immediately upon the power plant and hydro-electric system proposed to be constructed by the party of the second part upon the real property forming part of the property so to be acquired by the party of the second part; and

Whereas, the purchase by the party of the second part from the parties of the first part of the properties, easements and rights described in said two indentures hereunto annexed and the form of this agreement have been approved by the Railroad Commission of the State of California in its decision No. 3773, made and entered on the 10th day of October, 1916;

Now, therefore, in consideration of the mutual covenants hereinafter expressed, the parties hereto do agree as follows:

First: The parties of the first part agree forthwith to execute, acknowledge and deliver unto the

party of the second part two indentures substantially in the form of the drafts of indentures hereunto annexed and respectively marked Exhibit "A" and Exhibit "B" conveying and assigning to the party of the second part all the properties, easements and rights in such indentures described.

Second: The party of the second part, upon the execution and delivery to it by the parties of the first part of such indentures, and as part consideration for the properties, rights and easements thereby conveyed, agrees to issue to said Fontana Company a certificate of stock representing fifty (50) fully paid shares of the capital stock of said party of the second part, and to issue and deliver to said Fontana Union Water Company a certificate representing fifty (50) fully paid shares of the capital stock of the party of the second part.

Third: The party of the second part further agrees to pay to said Fontana Company and Fontana Union Water Company, one-half to each, the difference between the value of said one hundred (100) shares of the capital stock of the party of the second part and the value of the properties so to be conveyed by the parties of the first part to the party of the second part, as soon as the value of said properties and the method of payment therefore can be agreed upon between the parties of the first part and the party of the second part, and approved by the Railroad Commission of the State of California, or fixed in some other manner in accordance with law."

The agreement refers to the transaction as a *purchase*. It refers to the 100 shares to be issued *as part consideration*, and the covenant is to *pay* the difference between the value of the property and the 100 shares.

In the supplemental application [T. 25] the transaction is referred to as a *purchase* for a total consideration of \$349,500 to be *paid*. There are numerous references to the *purchase price*, and the prayer is for leave to execute an agreement for the *payment of the remainder of the purchase price*.

Holding the agreement by its four corners, it shows an obligation on the part of appellant to pay the balance of the purchase price.

B. THE PAYMENTS WERE NOT NET PROFITS AS THE BOARD ERRONEOUSLY ASSUMED.

The agreement provided that "pending the fixing of the value of the properties so to be conveyed, and the payment of the remainder of the purchase price thereof," appellant should pay "all profits realized from the business of the party of the second part after paying all its operating expenses (including depreciation), taxes, interest, all obligations which it may incur or for which it may become responsible, and dividends of not exceeding eight per cent (8%) per annum, upon its outstanding capital stock" [T. 34].

The use of the expression "profits" in the agreement was unfortunate. The unthinking may assume it means net profits and requires the payment of that out of which dividends are paid or are payable, and hence, they conclude, the payment is a dividend. Nothing could be more wrong.

From "profits realized from the business" there is to be taken operating expenses, depreciation, taxes, interest, dividends and all obligations which appellant might incur or for which it might become responsible. If from gross

earnings or income there were taken operating expenses, including depreciation, taxes and interest, the remainder would be net profits or net income. But more is to come out and only that which remains, if any, is payable. The amount payable might be described as "unused profits."

The word "profits" was used in the agreement in stating a yardstick to determine the amount to be paid. The circumstances under which the agreement was made show it was intended as a temporary arrangement. Considering the relation of the parties and the circumstances, the agreement was not unusual. In building its power house, constructing a long steel pipe line, and embarking upon business, the extent of appellant's liabilities could not have been known, and it might well have been there would be nothing payable by appellant under the agreement. It would not have been surprising had the sellers waived interest or compensation for delay in payment of the purchase price. But they did not. They merely provided that if appellant's gross earnings exceeded operating expenses, dividends and amounts required for other purposes, the excess would be paid to the sellers.

The erroneous conception that the agreement required appellant to pay net income or surplus earnings (available in most corporations for dividends) permeates the findings and opinion of the Board, even reaching into the syllabus. The following excerpts from the findings and opinion will so show:

"pending such determination to pay to them all of its *net profits*" [T. 6].

"The amounts claimed by petitioner as deductions . . . were paid by petitioner to Water Co. pursuant to that provision of the agreement between the corporations calling for the payment of *all annual net income*" [T. 12].

"Since the commencement of petitioner's operations in 1917, all of its *net income* in excess of operating and other expenses and an 8 per cent dividend on its outstanding capital stock has been paid" [T. 12].

" . . . provides for payment to the Grantors . . . of all petitioner's *net earnings*" [T. 14].

" . . . the provisions for payment of petitioner's *earnings* to the Water Company is not found on the capital stock certificates" [T. 16].

"So long as the *annual net income* had to be paid to the Water Company the petitioner never could amass cash or free assets with which to repay the Water Co. at any time for the properties transferred" [T. 18].

"The mere fact that the aggregate *net income* paid over to the Water Company . . ." [T. 18].

"We must assume . . . that the company and the petitioner were satisfied with an arrangement whereby *all the profits* went to the Water Company under the agreement, and were not interested in creating any debtor-creditor relationship" [T. 19].

To what extent the erroneous conception of the Board respecting the measure of the payment may have influenced its opinion cannot be known, but it is apparent many of the quoted statements were based upon false premises.

That the payments were not the same as net income is established by the fact that, for the years involved, appellant's net taxable income (on which taxes were paid), apart from the payments to Water Company, amounted to \$6,930.17, \$1,919.93 and \$15,114.98, re-

spectively [T. 4]. This was equivalent to an average net income, in excess of the disputed payments, of \$7,985.03, or an earning of 76% on the par value of appellant's capital stock.

The unthinking may argue thus: This agreement required the payment of "profits." Dividends are paid out of profits. Therefore (they will conclude), the payments were a distribution of profits. The fallacy of such reasoning is to use the "Q. E. D." as a premise. All that is known is that the contract required a payment and laid down a yardstick for determining the amount. The nature of the payments must be determined before it can be known whether they were to be charged against gross earnings before net earnings or net profits might be ascertained.

C. THE RIGHTS AND RELATIONS OF THE PARTIES ARE TO BE DETERMINED BY THE PROVISIONS OF THE AGREEMENT AND ATTENDING CIRCUMSTANCES.

Appellant made application to the Railroad Commission for leave to purchase from Fontana Company and Water Company (said last two corporations being hereinafter sometimes referred to as "sellers") a power house site, rights of way and the right to use waters of Lytle Creek for power purposes for the consideration of \$349,500 [T. 25]. In this application appellant also sought a certificate of public convenience and leave to execute a mortgage and issue bonds [T. 7]. Unquestionably, action upon the application required extensive engineering studies, and the most involved and difficult of these would be determination of the value of the water power rights

of Lytle Creek, the flow of which would fluctuate seasonally and daily.

Appellant had acquired an option to purchase steel for the pressure pipe line to be constructed. This option expired October 6, 1916. Thereafter, the cost of steel would be "greatly increased" [T. 26].

After filing the application, it was found impossible to prepare and submit to the Railroad Commission at that time "data sufficient to enable the Railroad Commission to fix the value and approve the purchase price of said property" [T. 26]. To meet the urgency, appellant and sellers decided to convey the properties and fix the purchase price later, and leave of the Commission was sought to enter into the agreement subsequently executed. The alleged reason for making the agreement was "in order to prevent the loss of such valuable steel contract, and to provide further time within which data may be furnished to and considered by the Railroad Commission for the fixing of the value and approval of the purchase price of the properties so to be conveyed by Fontana Union Water Company and Fontana Company to Fontana Power Company" [T. 26].

The reason for making the agreement and the language of the agreement are so clear and certain that its legal effect and meaning are to be resolved from its language and the surrounding circumstances. The case should not be confused with cases determined by other principles, such as those involving attempts to distribute profits under the guise of debt payments, or to evade taxes.

At the time the agreement was made, the Revenue Act of 1913 was in effect and imposed a 1% tax on the net income of individuals and corporations. It was not until

the United States entered the World War and the Revenue Act of 1918 was enacted that taxes became sufficiently burdensome to receive consideration from business.

D. THE PAYMENTS WERE NOT ATTRIBUTABLE TO ANY RIGHTS OF WATER COMPANY AS HOLDER OF ISSUED SHARES.

The Board appears to have decided the case on the theory that the relation of Water Company to appellant was that of shareholder and not creditor. Hence, the payments were in the nature of dividends. The Board says "In a majority of the cases of this nature which have come before this Board, the instrument issued by the corporation has been some form of stock certificate" [T. 15]. Nowhere in the extensive briefs filed with the Board was there any express discussion of such theory.

The ultimate question for determination is the nature of the payments. Were they paid as dividends or in discharge of a debt? If the payments were attributable to a creditor relation, they were interest or an expense of business. If attributable to the shareholder relation, they were dividends.

It should be noted there are two classes of cases. The facts are easily distinguished but principles are sometimes confused. In one, the recipient is admittedly a shareholder. The fact of shareholding is not involved. But the payment is made under the guise of discharge of indebtedness as for salary or rent. The payee is an admitted shareholder, but also claims to be a creditor. The matter for determination is how much of the payment, if any, was attributable to the creditor relation, and how

much, if any, was attributable to the shareholder relation? Such cases may involve questions of tax evasion.

In the other class of cases the question is whether the payee is a creditor or shareholder. The most common of these involve debenture shares. The holder of debenture shares may also hold other shares, such as common. But such other shareholding is merely incidental. The payment is not attributable to such other shares.

In the instant case, Water Company was a shareholder. But that was incidental. The payments were not attributable to the holding by Water Company of 100 shares of common stock. The payments were attributable to rights distinct from the rights of Water Company as the holder of 100 shares. They were made because of an obligation imposed on appellant by the agreement. It is immaterial who owns this agreement, that is, who may be entitled to the payments under it, whether a shareholder or a non-shareholder, just as it is immaterial who holds the debenture shares. The terms of the debenture shares will determine whether there exists the debtor-creditor relation or that of shareholder.

If Water Company should sell a half interest in the agreement to one holding none of appellant's shares, retaining the other half interest and the 100 shares, it could not be that the payments to Water Company were dividends while those to the non-stockholder were something else.

The payment of moneys by a corporation to shareholders who take by reason of a contractual obligation, rather than by virtue of being stockholders, does not constitute a distribution in the nature of a dividend, notwithstanding the fact that the moneys so paid would have

constituted surplus profits but for the contractual obligation. *Uniform Printing and Supply Company v. Commissioner* (1937-C. C. A. 7), 88 F. (2d) 75, 109 A. L. R. 966.

E. APPELLANT COULD NOT ISSUE STOCK OR LONG TERM EVIDENCES OF INDEBTEDNESS WITHOUT APPROVAL OF RAILROAD COMMISSION.

At the time of its incorporation, and subsequently, appellant was subject to the Public Utilities Act of California adopted in 1915. (*Cal. Stats. 1915, p. 115.*)

Section 52(a) of that Act provided:

“The power of public utilities to issue stocks and stock certificates, and bonds, notes and other evidences of indebtedness and to create liens on their property situated within this state is a special privilege, the right of supervision, regulation, restriction and control of which is and shall continue to be vested in the State, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe.”

And in section 42(b) of said Act was the provision:

“A public utility may issue stocks and stock certificates, and bonds, notes and other evidences of indebtedness payable at periods of more than twelve months after the date thereof, for the following purposes and no others, namely, for the acquisition of property, or for the construction, completion, extension or improvement of its facilities, . . .”

Emphasizing the limitation upon the power to incur indebtedness was the provision in said section 52(b):

"A public utility may issue notes, for proper purposes and not in violation of any provision of this act, or any other act, payable at periods of not more than twelve months after the date of issuance of the same, without the consent of the commission."

It may be assumed that appellant might have acquired the property for cash or notes payable in not more than twelve months, but to acquire it for stock or evidences of indebtedness not payable within twelve months definitely required the approval of the Commission.

F. APPELLANT COULD NOT HAVE CREATED A STOCK INTEREST WITH RIGHTS LIKE THOSE CREATED BY THE AGREEMENT.

The rights of Water Company were created by and are held pursuant to the agreement. Such rights are those of either creditor or stockholder. If the agreement establishes a stock interest or if the rights of appellant under the agreement are those of stockholder, appellant must have two classes of stock, one herein called orthodox stock provided for in the Articles of Incorporation, and the other called unorthodox stock created by the agreement.

Among other things, these classes have different dividend rights, the orthodox stock having priority over the unorthodox stock to the extent of 8% dividends. The orthodox stock has voting power while the unorthodox stock has no voting power. The orthodox stock is divided into shares of the par value of \$100. The unorthodox is not divided into shares, or perhaps consists of one share, and it has no par value.

Under the California constitution in effect at the time the agreement was made, a California corporation could not have par and non-par shares, nor shares of different par values, nor shares with different voting rights.

California Constitution Art. XII, Secs. 3 and 12;
Del Monte L. & P. Co. v. Jordan, 196 Cal. 488,
238 Pac. 710;

Land Development Company v. Jordan, 198 Cal.
346, 245 Pac. 187;

6a *Cal. Jur.*, p. 362.

At that time the constitution had very restrictive and exacting provisions relating to corporations. Among other things, it was provided that each stockholder should be personally liable for that part of the corporation's debts that the amount of stock owned by him bore to the whole of the subscribed capital stock.

If the agreement in question made Water Company a stockholder, what would have been its liability to the creditors of appellant? Any suit upon the agreement to establish a liability of Water Company as stockholder would have been demurred out of Court so quickly that wonder would never cease it had been brought. Even today, when shares are classified, there must be a statement of the classes, preferences, privileges and restrictions in the Articles (Cal. Civil Code, Sec. 290), and certificates for shares must be issued, which must contain a similar or equivalent statement (Cal. Civil Code, Sec. 326).

Assuming the agreement was susceptible to two constructions, one creating the debtor-creditor relation, and the other a stockholder relation, and the former was legal

and valid and the latter was contrary to law or public policy, the former construction will be adopted (13 C. J. 539).

As hereinbefore shown, appellant might only issue stock and long-term indebtedness for certain purposes and with the approval of the Railroad Commission. The Commission authorized the agreement under which the payments were made. Did the Commission intend by this agreement to authorize the issuance of stock or the creation of a debt or liability. Any claim that the Commission intended to authorize the issuance of shares is unfounded.

If the parties to the agreement had intended that the interest under the agreement should be a stock interest, and had they employed the most appropriate words known to them to express such intent and had the Railroad Commission expressly approved the agreement with such expressed intent and authorized the creation of a stock interest, it would have been ineffectual, for it was not within the power of the parties nor of the Railroad Commission to create a stock right or interest in appellant of the nature of that shown by the agreement. The California Constitution prohibited it.

And still, the Board has necessarily held that a thing may be done indirectly that could not be done directly; that a result will be obtained unwittingly that could not be obtained wittingly, and that one may be a stockholder unintentionally when he could not be one intentionally.

G. AN OBLIGATION TO PAY, ENFORCEABLE BY THE OBLIGEE, ESTABLISHES THE RELATION OF DEBTOR-CREDITOR.

In the instant case, Water Company had an unconditional right to the amounts appellant agreed to pay pending payment of the balance of the purchase price, and Water Company could have enforced such right by suit or other appropriate action and without regard to general or other creditors. Water Company also had an unconditional right to the balance of the purchase price and such right could have been enforced by appropriate action which might have involved the Railroad Commission had it been in existence and refused to act. In any event, performance or non-performance was not controlled by appellant, and appellant could not postpone time of performance any more than could a debtor, by dilatory tactics, postpone time of payment of his debt.

As no time was provided in the agreement for payment of the balance of the purchase price, it was payable on demand or in any event within a reasonable time.

Where a corporation is definitely obliged to pay "dividends" on and to redeem its "preferred" stock, the "dividend" payments constitute interest under the Revenue Act.

Commissioner v. Proctor Shop, Inc. (1936- C. C. A. 9), 82 F. (2d) 792;

Commissioner v. Palmer, Stacy-Merrill, Inc. (1940- C. C. A. 9), 111 F. (2d) 809;

Arthur R. Jones Syndicate v. Commissioner (1927- C. C. A. 7), 23 F. (2d) 833.

In the *Proctor Shop* case, *supra*, the capital stock authorized by the articles was 10 shares of common of the par value of \$100 each and 990 shares of debenture preferred stock of the par value of \$100 each. All of the debenture stock was taken and held by the father of the president. The articles provided for 6% cumulative interest on the debenture stock, payable quarterly, before any dividends were paid on the common and required the corporation to redeem at least \$1,500 per month of the debenture stock. Failure to pay the "interest" for two years as the same became due, authorized the holders of the delinquent stock to declare the principal due and institute action against the corporation for the principal amount and accrued interest. All general creditors ranked ahead of the holders of the debenture shares. In its annual report to the state corporation department, the corporation reported the debenture stock as a part of its authorized capital.

There was no question there (as there is here) of the power of the corporation to issue stock with such characteristics and there was no question of the validity of the debenture shares either as stock or indebtedness. Notwithstanding the provisions of the articles and the clear intent of the corporation to issue stock and establish a stockholder relation, the payments were held to be interest. That decision turns upon the fact that the corporation was obligated to redeem the shares, and possibly the right to sue in event of failure to pay interest for two years. These two facts overcame the manifest intent to make the holder have a stock interest.

Nearly all of the reasons advanced by the Board in the instant case for holding appellant to have a stock interest

could have been more appropriately advanced in the *Proctor Shop* case.

It is a fact that both creditors and shareholders of a corporation have an "interest" in it, and each has an investment. But a proper decision can never be reached by considering whether one is "interested" in the other or has the interest of an investor.

In the *Proctor* case the common stock interest was 1% and the debenture interest held by one person was 99%. In the instant case (attributing a total of \$350,000 to the properties), the stock interest represented by 105 shares is 3% and the other interest represented by the agreement is 97%. Why, in the *Proctor* case, did this Court not say, in effect, that debenture shares represented the real interest in the corporation and, hence, "the relationship . . . was that of an investor and not that of a creditor," as the Board said in the present case? That was not said in the *Proctor* case because the question cannot be answered through such approach.

In the *Arthur R. Jones Syndicate* case, one party took at par all of an issue of \$250,000 14% debenture shares. These were payable at a definite time. Therefore, although called shares, and authorized by the articles, and valid under the law, the payments were held to be interest.

In the numerous cases involving debenture shares, the legal power and right of the corporations to issue the shares with the terms and provisions there applicable were not involved. Apparently in all instances the debenture shares under consideration had been issued pursuant to and in compliance with law and the Articles of Incorporation and after formal and deliberate corporate action.

But in the instance case, as shown elsewhere, it was not within the power of appellant to create such stockholder relation—not even with the approval of the Railroad Commission—for such was prohibited by the constitution and also by the Civil Code of California.

H. THE REASONS ADVANCED BY THE BOARD ARE NOT WELL FOUNDED.

In the opinion of the Board, it was written “Had the Water Co. wanted to treat the transaction merely as a loan, with a definite annual income, in the nature of interest, from the transaction, it could have demanded a certain fixed payment from the petitioner each year until a certain fixed date, when the principal should become unconditionally due” [T. 16].

The statement ignores the reasons that induced the agreement and that appellant might not incur an obligation payable after 12 months without authorization by the Commission. The parties started out to make definite terms, but the time element upset their plans. They, therefore, made an agreement that was intended as a substitute until the definite terms could be settled. They postponed finishing that which they had started.

Had the parties made a permanent and final arrangement providing for paying unused profits, there might have been better grounds for inferring the interest of Water Company thereunder was intended to be a stock interest. But the agreement shows the purchase price *to be paid* remains for determination. If the agreement made shareholders of Water Company and Fontana Company, why bother thereafter to fix the purchase price?

An agreement of the nature suggested by the Board would not have been appropriate. Why should they have provided for periodic payments over the years "until a certain fixed date when the principal should become unconditionally due"? Had the purchase price been known or determined at that time, it is quite probable they would have provided for periodic payments "until a certain fixed date when the principal should become unconditionally due." The parties were not free agents as the Board implies. Such an agreement could not have been made without approval of the Commission, and it is improbable the Commission would have approved an obligation providing for definite payments until the purchase price was established.

The Board seems to think that a promise to pay a definite amount indicates a creditor relation because that is usually done. Debtors and creditors generally do know the amount of debt and agree upon an interest rate. But there are many exceptions, among them being the debenture share cases where the amount invested and the dividend or interest rate is certain. Nor does it apply where the amount of debt is not known.

Suppose an individual had purchased these properties and had made the same agreement that appellant did. The stockholder relation could not exist in such case. Would the agreement have created a stockholder relation if the purchaser were a corporation, but a debtor-creditor relation if the purchaser were an individual?

In the Board's opinion, it is written [T. 17]:

"No amount equivalent to the value of the properties transferred could have been paid in cash by petitioner at that time, inasmuch as it had neither cash nor unpledged assets; nor could it ever be paid

in the future if the Water Company held petitioner to the terms of the agreement because so long as the annual net income had to be paid over to Water Co. the petitioner never could amass cash or free assets with which to repay the Water Co. at any time for the properties transferred.”

The foregoing is a naive argument. It appears to assume that corporations come into this world with an inheritance. It ignores the fact that corporations do sell their shares for cash, or acquire property for them. It overlooks the fact that appellant had pending before the Railroad Commission an application to acquire the properties for \$349,500, when, because of time consideration, the application was side-tracked. It improperly concludes that appellant could not have secured the \$349,500, or such amount as the Commission might have approved as the purchase price, with which to acquire the property. It erroneously assumes that all of appellant’s net income was payable under the agreement, in lieu of as much of it as appellant did not require for dividends and other obligations. It disregards the fact that at the time the opinion was rendered appellant must have paid off the greater part of its bond issue, unless it had defaulted under the trust indenture. In brief, the quoted statement is 100% wrong.

Also, in the opinion of the Board is the statement [T. 19]:

“From the facts it appears that in all the years from 1917 until the present time there was no attempt made to agree on a valuation of the properties. . . . We must assume . . . Water Co. . . . and the petitioner . . . were not interested in creating any debtor-creditor relationship.”

In the foregoing, there is an inference that the parties could have changed their relationship. If the original agreement created a stockholder relationship, then to convert that to a debtor-creditor relationship would have necessitated the purchase by appellant of an outstanding stock interest or the redemption of stock. Under the law, appellant could not have done that.

It is probable the Board means to say that the subsequent actions of the parties indicate they intended in the first instance to create a stockholder relation. Ordinarily, acts of parties to an agreement by way of performance may be helpful in determining the meaning of the agreement. But any conclusion that the subsequent failure to fix the purchase price shows the parties intended never to fix it or shows that they intended the agreement should be permanent and the measure of their rights, is unjustified. It ignores the reasons for making the agreement and the clear language of the agreement itself.

Before this agreement was finally approved by the Commission [T. 38] the United States was in the World War and there were other things more important for engineers than valuation studies of water power, and the market for stock that existed in the early fall of 1916 was non-existent. If thereafter the parties found the arrangement workable and maintained the status quo, that would not convert a debtor-creditor relation that arose when the contract was executed into a shareholder relation.

Even had the agreement provided that payment of the purchase price when determined was to be made with appellant's stock at par, such would not have made the compensation payments dividends. *Fidelity Savings and Loan Association v. Commissioner*, 23 B. T. A. 1059.

II.

The Payments Involved Constituted Interest.

Section 23(b) of the Revenue Act of 1934 and the same section of the 1936 Act provided:

"In computing net income there shall be allowed as deductions . . . (b) Interest. All interest paid or accrued within the taxable year on indebtedness."

Interest is compensation for the use, forbearance or detention of money. 33 C. J. 178; *Fall River Electric Light Company v. Commissioner*, 23 B. T. A. 168. It is usually reckoned by a percentage. 4 Words & Phrases, p. 3708 citing Abbott's Law Dictionary and 11 Am. & Eng. Enc. Law 379. The fact that it is usually reckoned by a percentage negatives any claim that it is always so reckoned. Numerous cases where not reckoned by a percentage are where usury has been paid in property. 66 C. J. 212. But a contract is not usurious where the amount of interest is affected by a contingency putting the whole of it at hazard, even tho the probable amount is greater than lawful interest. 66 C. J. 136. Sometimes it is reckoned as a percentage of profits, as it was in the recent case of *Kena, Inc. v. Commissioner*, 44 B. T. A., No. 39.

In the *Kena* case the question was whether or not moneys received by a taxpayer corporation were interest. If they were, the taxpayer was a personal holding company. The stock was held by one de Mauriac and his wife. A large sum of money was "loaned" to de Mauriac for

stock trading, which he agreed to repay, together with "an additional sum of money *in lieu of interest*, which additional sum shall be an amount equal to 80 per cent of the net profits of de Mauriac in his stock trading business." The 80% was subsequently reduced to $66\frac{2}{3}\%$, and taxpayer received \$124,000 as $66\frac{2}{3}\%$ of the profits for the tax year involved. In passing on this situation the Board said:

"The contract of December 13, 1932, denominated the amount to be paid to the petitioner as an additional sum in lieu of interest. The word 'lieu' means 'place or stead.' It does not imply that the character of the payment was different from interest but indicates that the method of computation was not in accord with the usual method of computing interest, the percentage of profit being employed as a substitute. . . .

The record convinces us that the amount originally delivered to de Mauriac and the amount subsequently advanced under the extended agreement were loans of cash made by the petitioner to de Mauriac. The amounts paid for the use of such borrowed money were interest thereon.

It is not essential that interest be computed at a stated rate, but only that a sum definitely ascertainable shall be paid for the use of borrowed money, pursuant to the agreement of the lender and borrower."

It is not necessary that a payment be denominated or paid as interest to be deductible as interest. In many of the debenture share cases the payment held to be interest was termed a dividend. The portion of an annuity payment representing interest may be deducted by an annuity writer. *Commissioner v. John C. Moore Corp.*, 42 F. (2d) 186. A bonus for a loan, although payable in the form of dividends, has been held interest. *Wiggin Terminals, Inc. v. U. S.*, 36 F. (2d) 893.

Under treasury regulations, payments of Maryland or Pennsylvania ground rents are deductible as interest if the ground rent is redeemable, but if irredeemable are deductible as rent to the extent they constitute a proper business expense. Reg. 103, sec. 19.23 (b)-1. A payment may be in part interest and in part a dividend. *Helvering v. Richmond, F. & P. R. Co.*, 90 F. (2d) 971, where payments to the extent of 7% of the par value of the guaranteed stock were held to be interest, and the excess to be dividends.

III.

The Payments Were Deductible as Ordinary and Necessary Expenses of Business.

Section 23(a) of the Revenue Act of 1934 and the same section of the Act of 1936 stated:

"In computing net income there shall be allowed as deductions: (a) Expenses. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

In determining what is ordinary and necessary expense in a given business, the facts peculiar to that business as it has been constituted and is conducted must be considered, and an expense might be ordinary and necessary in one instance where in another it was not, and this is true whether the businesses are similar or different. The statute singles out the taxpayer and allows him a deduction for ordinary and necessary expense in his business as it is constituted and conducted.

As noted, the treasury holds that payments under an irredeemable ground rent are deductible "to the extent they constitute a proper business expense." Such deductions are not allowed under the provisions of section 23(a) authorizing deductions of rentals, for in the case of the ground rent, as in the instant case, fee title has been conveyed, and the relation of the parties is not that of landlord and tenant and that which is paid is not orthodox rent.

Where one transferred all interest in certain coal leases to another under an agreement that the assignor should be paid certain amounts on the coal produced, it was held such payments, although neither rent nor royalties, were

a charge upon the business and were deductible as ordinary and necessary expense of the business. *Buffalo Eagle Mines, Inc. v. Commissioner*, 37 B. T. A. 843. Where a consolidated corporation agreed to pay two shareholders of a constituent corporation $12\frac{1}{2}\%$ of the net profits before any dividends were declared, the payments were held ordinary and necessary expense of the business. *George La Monte & Son v. Commissioner*, 32 F. (2d) 220. In the case last mentioned the Court said respecting the fact that the payment was determined by profits, "it is not the method of determining the amount of the charge which is controlling, or even of importance; it is the character and nature of the charge."

Where a film company contracted with ten manufacturers, each owning 10% of its stock, to lease their films at nine cents a foot, plus a payment at the end of the year in proportion to the footage leased, equal to its profits after paying dividends on its common and preferred shares at specified rates, the additional payments, although taking all net profits above dividends, were held to be an expense of the business and not a distribution of dividends. *In re General Film Corporation*, 274 F. 903.

Where a very substantial salary was paid to the seller of a business to direct or assist the purchasers in conducting the business, the salary payments were ordinary and necessary expenses of the business. *Nehi Bottling Company*, B. T. A. memo, Docket No. 102054, May 27, 1941. And where a corporation leased from its president and majority shareholder a lumber yard, office and other buildings at an annual rental of half of the corporation's income from such sources, the amount so paid was deductible as rent. *Canfield Lumber Company v. Commissioner*, B. T. A. Memo, June 7, 1940.

The agreement in question was made in connection with acquiring the property required and used by appellant in its business. Without such property, appellant could not have started its business, nor without it, could it continue. The payments in the instant case are as ordinary and necessary as are the royalty payments under the lease of a coal mine, or as interest on a purchase money obligation or as rent for property used in a business, for in the instant case the obligation to make the payments arose in connection with the acquisition of the property, namely, the power house site, the right of way for the pipe line, and the right to use the water for power purposes.

Conclusion.

For the reasons hereinbefore given, the decision of the Board is erroneous and should be reversed.

Respectfully submitted,

GEO. W. HELLYER,

JOHN B. SURR,

Counsel for Appellant.

No. 9901

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

FONTANA POWER COMPANY, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

J. LOUIS MONARCH,
SHERLEY EWING,
*Special Assistants
to the Attorney General.*

FILED

NOV 24 1941

PAUL F. O'BRIEN

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	1
Statutes involved	2
Statement	4
Summary of argument	7
Argument:	
The payments were not deductible because they were distribu-	
tions in the nature of dividends	7
Conclusion	15

CITATIONS

Cases:

<i>Angelus Building & Investment Co. v. Commissioner</i> , 57 F. (2d)	
130, certiorari denied, 286 U. S. 562	8
<i>Bakers' Mutual Coop. Ass'n v. Commissioner</i> , 117 F. (2d) 27	9
<i>Brown-Rogers-Dixson Co. v. Commissioner</i> , 122 F. (2d) 347	9
<i>Chattanooga Sav. Bank v. Brewer</i> , 17 F. (2d) 79, certiorari denied,	
274 U. S. 751	9
<i>Christopher v. Burnet</i> , 55 F. (2d) 527	9
<i>Commissioner v. Palmer, Stacy-Merrill</i> , 111 F. (2d) 809	11
<i>Commissioner v. Proctor Shop</i> , 82 F. (2d) 792	8
<i>Continental Co. v. United States</i> , 259 U. S. 156	9
<i>Deputy v. DuPont</i> , 308 U. S. 488	8
<i>Doernbecher Mfg. Co. v. Commissioner</i> , 95 F. (2d) 296	8
<i>Helvering v. Richmond, F. & P. R. Co.</i> , 90 F. (2d) 971	12
<i>Hill v. Commissioner</i> , 66 F. (2d) 45	8
<i>Hudson v. Commissioner</i> , 99 F. (2d) 630, certiorari denied, 306	
U. S. 644	8
<i>Jones, Arthur R., Syndicate v. Commissioner</i> , 23 F. (2d) 833	11
<i>LeMoyne v. Commissioner</i> , 47 F. (2d) 539	9
<i>Old Colony R. Co. v. Commissioner</i> , 284 U. S. 552	10
<i>Pepper v. Litton</i> , 308 U. S. 295	14
<i>Taylor v. Standard Gas Co.</i> , 306 U. S. 307	14
<i>United States v. South Georgia Ry. Co.</i> , 107 F. (2d) 3	9

Statutes:

Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23 (U. S. C., Title 26, Sec. 23)	2
Sec. 115 (U. S. C., Title 26, Sec. 115)	3
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23	3
Sec. 115	3

Miscellaneous:

I. T. 2385, VI-2 Cum. Bull. 185 (1927)	14
--	----

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 9901

FONTANA POWER COMPANY, A CORPORATION, PETITIONER
v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion is that of the Board of Tax Appeals (R. 5-21) reported in 43 B. T. A. 1090.

JURISDICTION

This appeal involves income and excess profits taxes for the years 1935, 1936 and 1937 and is taken from a decision of the Board of Tax Appeals entered March 29, 1941. (R. 21-22.) The case is brought to this Court by petition for review filed July 10, 1941 (R. 22-24), under the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether payments, amounting to all profits after operating expenses, taxes, and an eight percent divi-

dend, made to the only stockholder (other than qualifying shares) of the taxpayer pursuant to an agreement entered into in 1917 were deductible from the gross income of the taxpayer under Section 23 of the Revenue Acts of 1934 and 1936 or whether such payments constituted nondeductible payments in the nature of dividends.

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses*.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest*.—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the

taxpayer) the interest upon which is wholly exempt from the taxes imposed by this title.

* * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term “dividend” when used in this title (except in section 203 (a) (4) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

* * * *

(U. S. C., Title 26, Sec. 115.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

The provisions of Section 23 (a) and (b) are identical with those of the Revenue Act of 1934, above quoted.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term “dividend” when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * *

STATEMENT

The material facts, summarized from the findings of the Board of Tax Appeals are as follows (R. 7-13):

The taxpayer was incorporated in California in 1916 and has continuously operated as a public utility subject to the jurisdiction of the Railroad Commissioner of the State of California. The Fontana Union Water Company was also incorporated in California in 1912. It has been held by the Bureau of Internal Revenue to be exempt under Section 101 of the Revenue Act of 1934 and 1936 from income and capital stock taxation. The Fontana Company, incorporated in California prior to the taxpayer, was dissolved in 1927. All three companies had the same president. (R. 7.)

Prior to August 9, 1916, the taxpayer applied to the Railroad Commission for a certificate of public convenience and necessity in regard to the construction of an electrical power plant and system, for authority to execute a mortgage on its properties issuing thereunder \$350,000 face amount of first mortgage six percent bonds, and for permission to acquire from the Water Company and the Fontana Company certain properties. Later in the same year, the taxpayer filed a supplemental application stating that it appeared impossible to submit sufficient data for the Commission to determine the value of the properties and that an option owned by the taxpayer for the purchase of certain steel would expire shortly and that thereafter the price of the steel would be considerably higher. Taxpayer proposed to enter into an agreement providing for the immediate conveyance of the properties to

it. The consideration was 100 shares of capital stock of the taxpayer, the taxpayer's agreement to pay the vendors the difference between the value of the 100 shares and the value of the properties as soon as the value and the method of payment could be agreed upon by the three companies and approved by the Commission, and the further agreement of the taxpayer that meanwhile it would pay to the vendors all its earnings after providing for the payment of operating expenses, taxes and interest on all obligations which it might incur. (R. 7-9.)

On October 10, 1916, the Railroad Commission granted authority for the issuance of 100 shares of capital stock of the taxpayer at a par value of \$100 as part payment to the vendors and permission to issue the \$350,000 principal amount of its first mortgage six percent bonds. Authority was also granted to enter into the proposed contract with the vendors. Subsequent orders were issued approving the mortgage and trust deed and stating that the bonds were secured by a mortgage on all of taxpayer's property, then owned or thereafter acquired. In 1937 it was provided that taxpayer could deduct charges for discount of the outstanding bonds in calculating net income under the agreement. (R. 9-10, 11.)

The bonds were issued in the amount of \$350,000 and the proceeds were used in the development of taxpayer's property. The property and rights acquired from the vendors were leased by the taxpayer to the Southern California Edison Company for 30 years beginning July 1, 1917. The lessee operates the property and pays rental based upon the power generated in excess

of that required by the taxpayer for supplying its customers. (R. 10, 12.)

Upon incorporation five qualifying shares were issued, and pursuant to the agreement 50 shares each were issued to the Water Company and the Fontana Company. In 1927 the Fontana Company was dissolved (R. 7) and the Water Company acquired its 50 shares and all of its rights under the agreement. The Water Company has been, and still is, the owner of the 100 shares which, along with the five qualifying shares, are the only shares that have ever been issued. (R. 10-11.)

The value of the properties conveyed to the taxpayer by the Water Company and the Fontana Company has never been fixed, nor has the method of payment been determined. In fact, no attempt has been made to value it or to secure approval of the Railroad Commission. Since the beginning of taxpayer's operations in 1917, all of its net income in excess of operating and other expenses and an 8 percent dividend on its outstanding capital stock has been paid to the Water Company and/or the Fontana Company pursuant to the agreement. The taxpayer has never acquired any property of substantial value other than that conveyed to it by the vendors and acquired from the proceeds of the sale of the bonds. From 1917 to date, taxpayer has deducted from its gross income the payments made in its federal tax returns and its annual reports to the Railroad Commission. (R. 11-13.)

The Commissioner determined deficiencies in income tax for the years 1935, 1936 and 1937 in the amounts of \$2,535.66, \$1,758.22 and \$3,130.50, respectively, and also deficiencies in excess profits tax in the respective

amounts of \$922.42, \$189.87 and \$2,787.58, as the result of disallowing as deductions the payments made pursuant to the agreement. (R. 1, 6.) The Board of Tax Appeals affirmed the Commissioner's determination and the taxpayer has brought the case here for review.

SUMMARY OF ARGUMENT

Since the taxpayer is seeking a deduction from gross income, it must affirmatively show that the claimed deductions come strictly within the statutory provisions. Many cases of a similar nature have been decided and it is well recognized that they depend upon the facts and circumstances of each particular situation. Here the stock represents the full value of the assets and there should be no tax deduction for payment of the profits to the stockholders. There was no creditor relationship and the payments could not be termed "interest" in view of the actual situation. The payments were not similar to ground rents, nor were they necessary and ordinary expenses of the business of the taxpayer.

ARGUMENT

The payments were not deductible because they were distributions in the nature of dividends

In attempting to bring these payments within the limitations established by Congress for deductions from gross income, the taxpayer argues that the payments were made to the Water Company as creditor and not as stockholder (Br. 10-29); that the payments constituted interest (Br. 30-32); and that they were ordinary and necessary expenses of the business (Br.

33-35). Taxpayer has emphasized that payments were attributable to the agreement, which was made in respect to the purchase of the properties (Br. 10-18), and that the taxpayer could not under the laws of California have issued stock without the approval of the State Commission nor could it have created a stock interest with rights like those created by this agreement (Br. 19-22).

It cannot be denied that the taxpayer is seeking a deduction from gross income and therefore must strictly comply with the statutory standards. *Deputy v. DuPont*, 308 U. S. 488. It hardly seems necessary to labor the point that it is well recognized that the numerous cases involving this particular question are based fundamentally upon the particular facts and circumstances. *Commissioner v. Proctor Shop*, 82 F. (2d) 792 (C. C. A. 9th). There have been numerous instances where payments or distributions have been held to be dividends although they were labeled, or appeared to be, something else. It is clearly not necessary that the particular distribution be termed a dividend. Among the payments which have been held dividend distributions may be noted the following: distributions from a trust (*Angelus Building & Investment Co. v. Commissioner*, 57 F. (2d) 130 (C. C. A. 9th), certiorari denied, 286 U. S. 562); excessive salaries (*Doernbecher Mfg. Co. v. Commissioner*, 95 F. (2d) 296 (C. C. A. 9th)); redemption of outstanding stock (*Hill v. Commissioner*, 66 F. (2d) 45 (C. C. A. 4th)); cash withdrawals (*Hudson v. Commissioner*, 99 F. (2d) 630 (C. C. A. 6th), certiorari denied, 306 U. S.

644); transfer of certificates of interest in a newly organized company (*Continental Co. v. United States*, 259 U. S. 156, 176-177); interest on preferred stock (*United States v. South Georgia Ry. Co.*, 107 F. (2d) 3 (C. C. A. 5th)); rent paid to controlling stockholder (*LeMoyne v. Commissioner*, 47 F. (2d) 539 (C. C. A. 9th)); payments on certificates of deposit (*Bakers' Mutual Coop. Ass'n v. Commissioner*, 117 F. (2d) 27 (C. C. A. 3d)); payments on "debenture preferred stock" (*Brown-Rogers-Dixson Co. v. Commissioner*, 122 F. (2d) 347 (C. C. A. 4th)). Moreover, it is not necessary that there be a formal dividend declaration in order that the payment may be considered for tax purposes as a dividend. *Chattanooga Sav. Bank v. Brewer*, 17 F. (2d) 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751. Nor can the principal stockholder complain that a distribution is not actually a dividend on the ground that a minority interest, such as qualifying shares, did not participate in the distribution. *Christopher v. Burnet*, 55 F. (2d) 527 (App. D. C.).

The distributions in this case were made pursuant to an agreement whereby the taxpayer acquired certain properties. Under the agreement the taxpayer issued its stock as part consideration; agreed to pay to the vendors the difference between the value of the stock and the value of the properties; and pending the determination of that difference, agreed to pay to the vendors all of its profits. For twenty years thereafter the taxpayer distributed its profits pursuant to the agreement and it is these distributions which have been held to be dividends.

The vendors conveyed the property to taxpayer and became the sole stockholders.¹ The stock represented, therefore, the full value of the property conveyed. The recital of a purpose to determine later the amount of the difference in values is sheer nonsense. There was no such difference to be determined. The taxpayer's stock was worth whatever the properties conveyed were worth, no more and no less. No attempt has ever been made to determine this mythical difference (R. 13) and nothing has ever been paid on the "balance" of the purchase price. We submit that the taxpayer's whole case falls with this exposure of the fallacy of its premise.

In any event, if the validity of a putative balance should be assumed, we submit that the Board was justified in determining that the Revenue Acts do not authorize the deduction of payments of profits to stockholders. As long as ownership of the stock was vested in the same interests (and since 1927 it has been vested in the one owner, the Water Company) it would make no difference whether or not the "balance" of the purchase price was paid. No reason appears

¹ It is true that five other shares were issued at the time of incorporation. However, they were admittedly issued merely to qualify directors. (R. 10.) The record does not show to what individuals they were issued or exactly how they were held. For the purposes of this case we can ignore those minority interests. *Old Colony R. Co. v. Commissioner*, 284 U. S. 552. The record also shows that the Fontana Company was dissolved in 1927 and that its 50 shares of taxpayer's capital stock and rights under the agreement were taken over by the Water Company. (R. 7, 11.) Since all three companies had the same president (R. 7), it is not unreasonable to assume that the Water Company was the parent, or, at least, that all three were closely affiliated.

why the properties could not have been conveyed solely for stock. One share or a million could have been taken and the total value of the stock representing the property would have been the same. In providing for payment to the stockholders of all of the profits over operating expenses, taxes, and the agreed eight percent dividend, the vendors were merely taking what they were entitled to as stockholders and the Board was perfectly justified in deciding that it was paid to them in such capacity.

Merely by setting forth such right in contract form no creditor relationship is established. On this point the taxpayer relied principally on *Commissioner v. Palmer, Stacy-Merrill*, 111 F. (2d) 809 (C. C. A. 9th); *Commissioner v. Proctor Shop, supra*, and *Arthur R. Jones Syndicate v. Commissioner*, 23 F. (2d) 833 (C. C. A. 7th). In the first case this Court upheld decisions by the Board where the facts showed obviously that the payments, although labeled dividends on preferred stock, were in reality payments on a loan. Judge Healey in his concurring opinion pointed out (p. 810) that this Court is committed to the view that "the real intention of the parties is to be sought and in order to establish it evidence aliunde the contract is admissible." As pointed out in that case the *Proctor Shop* case was similar in that there was an obligation to pay "dividends" and to "redeem" preferred stock. Likewise, the *Jones* case was unquestionably a loan although the creditor took debenture shares bearing 14 percent interest to avoid the state usury laws. In none of these cases were the payments made to the true owners, or common stockholders.

It has been pointed out (see *Helvering v. Richmond, F. & P. R. Co.*, 90 F. (2d) 971 (C. C. A. 4th)) that the essential difference between the creditor and stockholder relationships is that in the former there is a lending of capital without risk while in the latter there is a desire to embark on a corporate adventure with the attendant risks of loss and chances of profit. Under the agreement in this case there was no lending of capital. The properties were transferred for the common stock. Until an agreed valuation could be made, the vendors received all of the profits—part in the regular form of dividends and the remainder in accordance with the terms of the agreement. The payments were not applied on the purchase price, but as a “temporary” expedient. So far as the vendors were concerned they were in no different position fundamentally than if they had never conveyed the property. They received all the net income from the property and the taxpayer merely carried on the business for their benefit. Certainly such a contract could not have been imposed on an independent purchaser; it was only because the vendors owned the taxpayer lock, stock, and barrel that the latter could conceivably agree to own and operate properties with all the return given to the former owners of the property, until such time as the vendors cared to value the property and secure approval of the Railroad Commission. The payments were to be made solely from the profits; there was no obligation to pay anything unless there were sufficient earnings. They fall squarely within the definition of “dividends” in Section 115 (a), quoted *supra*. In such circumstances, the Board was

justified in holding that the payments were made because of the stock ownership and not from any creditor relationship. Clearly taxpayer did not overcome the presumption of the correctness of the Commissioner's determination and, it is submitted, there was ample evidence to support the Board's conclusion.

Having erroneously reasoned that the payments were made because of a creditor relationship, the taxpayer naturally argues that the payments were interest. Nowhere have the parties termed this payment "interest" which has been defined as "the amount which one has contracted to pay for the use of borrowed money." *Old Colony R. Co. v. Commissioner*, *supra*, p. 560. It is not contended that any money was loaned. The argument appears to be that there was an obligation to pay interest on the difference between the value of the capital stock and the value of the properties. However, as the Board pointed out (R. 18), the payment of all net profits as so-called "interest" absorbed all the taxpayer's resources and made it impossible to pay off the principal. The self-serving nomenclature of the agreement cannot disguise the fact that the vendors here participated in the entire transaction as stockholders, and not as creditors with a secured obligation and a limited return. They bore the risks of loss from the possibilities of profitless operation.

It is suggested (Br. 21) that the agreement could not make the Water Company a stockholder with the attendant liability to creditors. This is pointless. The Water Company was a stockholder because it held the

stock. No one contends that the agreement made it a stockholder. Moreover, the alleged contract rights of stockholders may certainly be made junior to the claims of general creditors. *Taylor v. Standard Gas Co.*, 306 U. S. 307; *Pepper v. Litton*, 308 U. S. 295.

The intimation (Br. 32) that these payments are analogous to Maryland and Pennsylvania ground rents is equally without merit. As pointed out by the Board, those situations involve feudal relics calling for special treatment. They are in the nature of a deferred payment sale of real estate on the instalment plan, the redeemable ground rent being in reality a mortgage. I. T. 2385, VI-2 Cum. Bull. 185 (1927). In the instant case there was no conveyance subject to a mortgage—no lien of any kind was reserved to the grantors.

Finally the taxpayer contends that these payments are deductible as ordinary and necessary expenses. This is doubtless an alternative argument, since the statutory provisions dealing with interest and with expenses are mutually exclusive. It would be of no assistance to this Court to discuss the cases cited upon this point. They involve different facts and merely show that under other circumstances deductions may be allowable even though the payments were made to vendors or to stockholders. They do not show that the Board erred in carefully scrutinizing the dual relationship of the payees and they do not countenance a blind adherence to the form which taxpayers give to their transactions. As heretofore pointed out, this Court is committed to the view that the substance of the transaction should control. Here the substance was the payment

to the sole stockholder of all profits as such and the Board correctly disallowed the claimed deductions.

CONCLUSION

The decision of the Board of Tax Appeals was correct, founded on substantial evidence, and should be affirmed.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

J. LOUIS MONARCH,
SHERLEY EWING,

Special Assistants to the Attorney General.

NOVEMBER, 1941.

No. 9901

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

FONTANA POWER COMPANY, a corporation,
Petitioner and Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee.

APPELLANT'S REPLY BRIEF.

GEO. W. HELLYER,
JOHN B. SURR,
204 Citizens National Bank Building,
San Bernardino, California,
Counsel for Appellant.

FILED

DEC - 3 1941

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Commissioner v. Van Vorst, 52 Fed. (2d) 677.....	11, 12
Taplin v. Commissioner, 41 Fed. (2d) 454.....	12

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Respondent and Appellee.

APPELLANT'S CLOSING BRIEF.

Unless otherwise noted, all emphasis herein has
been added by appellant.

In appellant's opening brief (pp. 12, 13, 14), it was emphasized that the agreement under which the payments were made *did not* provide for payment of *all* of appellant's profits. Under such agreement there was to be deducted or taken from "profits", "operating expenses (including depreciation), taxes, interest, all obligations which it (appellant) may incur or for which it may become responsible, and dividends of not exceeding eight per cent (8%) per annum, upon its outstanding capital stock" [Tr. 34].

The agreement clearly defined the amount to be paid, but such amount was not "profits" within the lexicon of investors, lawyers and tax authorities.

In appellant's opening brief (p. 14) it was also emphasized that the payments were not the same as net income, for, after making and deducting them, appellant had for the three years involved, a net income of \$23,965.08, or an average annual net income of \$7,985.03, on which appellant paid income taxes.

There is no dispute respecting the foregoing statements. But it must be that respondent did not read appellant's brief or that respondent did not note or understand the correct facts involved, for at no place in respondent's brief are the true facts in this particular stated. On the contrary, every reference to such matters in respondent's brief is inexact and incorrect, and anyone reading respondent's brief would be left with an erroneous conception upon this phase.

Such erroneous statements commence on page 1, where, in stating the question, respondent refers to the payments as "amounting to all profits, after operating expenses, taxes and an eight per cent dividend".

The next reference is in the statement of facts, where on page 5 respondent erroneously declares the agreement required appellant to pay the vendors "all its earnings after providing for the payment of operating expenses, taxes and interest on all obligations which it might incur". (Perhaps this erroneous statement, apart from omission of dividends, is attributable to a typographical error! The agreement provided for deductions of ". . . taxes, interest, all obligations which it may incur or for which it may become responsible and . . .". Respondent changes this to "taxes and interest *on* all obligations which it might incur".)

The other references in respondent's brief to the terms of the agreement under consideration, and the payments, are as follows:

(No. 3) "taxpayer . . . pending the determination of that difference, agreed to pay to the vendors *all its profits*. For twenty years thereafter the taxpayer distributed its *profits* pursuant to the agreement" (p. 9).

(No. 4) "In providing for payment to the stockholders of *all of the profits over operating expenses, taxes, and an agreed eight per cent dividend*, the vendors were merely taking what they were entitled to as stockholders" (p. 11).

(No. 5) "Until an agreed valuation could be made, the vendors received *all of the profits*" (p. 12).

(No. 6) "They (vendors) received *all the net income* from the property" (p. 12).

(No. 7) ". . . the payment of *all net profits* as so-called 'interest' absorbed all the taxpayer's resources . . ." (p. 13).

(No. 8) "Here the substance was the payment to the sole stockholder of *all profits as such*" (p. 15).

The agreement provided a yardstick for determining the amount to be paid. But this yardstick was not "*all profits*" as respondent so persistently states. Respondent's erroneous statements recurring like the theme-song in Snow White, are well calculated to linger in mind.

The agreement provided for payment of the difference between the value of the properties conveyed to appellant and the 100 shares of stock issued as part payment. This difference may properly be referred to

as the balance of the purchase price. Such balance was payable when the value of the properties and the method of payment was agreed upon by the parties and approved by the Railroad Commission. On page 10 of his brief, respondent refers to this balance as "mythical" and writes "no attempt has ever been made to determine this mythical difference [R. 13] and nothing has ever been paid on the 'balance' of the purchase price". If respondent's statement had been confined to the time of hearing before the Tax Board, the statement would have been correct had the word "mythical" been omitted, but the statement is not restricted and speaks in the present tense. In this the statement is not correct. Subsequent to the hearing before the Tax Board, appellant and Water Company agreed that this balance or difference was the sum of \$340,000 and the Railroad Commission, after a public hearing, has under consideration appellant's application for leave to pay that amount.

In his brief, respondent does not appear to have followed the theory underlying the Board's opinion. The Board recognized that the payments were made under and pursuant to the agreement and that the holding of 100 shares of appellant's stock was extraneous. At the utmost, the Board looked upon such shareholding as throwing some light upon "the real intent of the parties", which the Board states "is to be ferreted out" [Tr. 16].

Respondent's theory appears to be that the payments were attributable to the holding of 100 shares of stock and the payments were made to Water Company as the holder of 100 shares of stock and, hence, were dividends on the 100 shares. That was the theory for which respondent contended before the Board. The Board did not

follow it. It was this situation that caused appellant to write at page 17 of appellant's opening brief:

"The Board appears to have decided the case on the theory that the relation of Water Company to appellant was that of shareholder and not creditor. Hence, the payments were in the nature of dividends. The Board says, 'In a majority of the cases of this nature which have come before this Board, the instrument issued by the corporation has been some form of stock certificate' [Tr. 15]. *Nowhere in the extensive briefs filed with the Board was there any express discussion of such theory.*"

The Board further said [Tr. 15] "in each proceeding of this nature it must be determined on the facts presented whether the real transaction was that of an investment in the corporation or a loan to it. (Case cited.) On this question the designation of the *instrument* and the terms therein incorporated, while not to be ignored, are not conclusive". After some discussion of the facts, the Board concluded "The transaction was strictly an investment from 1916 up to and including the taxable years. . . . It may be true that the agreement of 1916 indicated a possibility of the creation of a debtor-creditor relationship and the method to be followed if such a relationship were to be created in the future, but the mere existence of this possibility, which was never fulfilled, cannot affect our conclusion that, in reality, during the years in question the relationship of the Water Co. to petitioner was that of an investor and not that of a creditor".

Respondent writes (p. 11), "In providing for payment to the stockholders of all of the profits . . .

the vendors were merely taking what they were entitled to as stockholders" and (p. 13) "The Water Company was a stockholder because it held the stock. No one contends that the agreement made it a stockholder".

The agreement did not provide for payment to the stockholders as such of any amount. It provided for payment to those who at the time were also shareholders. The obligation would have continued whether the payees retained the shares or not. The payments were made pursuant to the agreement and not pursuant to any rights of Water Company and Fontana Company as holders of shares.

Respondent's statement that the vendors took "what they were entitled to as stockholders" is clearly wrong. They took 8% dividends as stockholders and they took the payments under the agreement as obligees or payees under the agreement.

Suppose a person conveyed property to a corporation in exchange for all of its shares and its bonds in the amount of \$100,000. Interest paid on the bonds to the bondholder (who also happened to be the sole shareholder) would not constitute a "distribution made by a corporation to its shareholders" so as to be a dividend within the income tax law. Nor would it make the payments dividends because the property had been conveyed and the stock and bonds issued as part of the same transaction. Nor would the interest payments have become dividends because the stockholder controlled the corporation, or was "friendly" to it, or the transaction was not made at arms length. For reasons that seemed sufficient to the incorporator, he might have caused the corporation to provide either a low or a

high interest rate. The possibility that the corporation's earnings might not be sufficient to pay the bond interest would not have made the holder of the bonds an "investor", *i. e.*, a shareholder as opposed to a creditor.

None of such matters in the supposititious case would have altered the basic fact that the bonds evidenced a debt and payments on them were made because of the debtor-creditor relation, and not because the holder of the bonds also held the corporation's shares.

Generally those forming a corporation are friendly to it, and it is responsive to their desires and gives effect to their plans within the law. This is probably more true in the case of the private corporation than in the case of a public utility in California, where, under the law, stocks, bonds and notes of a public utility can be issued only for certain considerations with the approval of the Railroad Commission.

Suppose in the instant case, Water Company disposed of the 100 shares to which respondent attaches such significance. Would not appellant be required to make the same payments that it had theretofore made. Clearly it would. Then it follows that the payments are made because of the agreement and not because of the holding of 100 shares of stock. If the shares were disposed of, then the question would be whether the payments were made to Water Company because of a shareholder or a debtor-creditor relation. But that relation arises under the agreement and the final question is whether the agreement either alone, or taken in connection with all the circumstances, creates a debtor-creditor relation or a shareholder relationship.

Respondent's theory that the payments were attributable to the holding of 100 shares is unsound. The Board's theory is the only possible theory on which it might be held that the payments were dividends. But that theory finally runs against the barrier of the law. The Board's theory means that the agreement construed with attending circumstances, but without regard to who holds the 100 shares, creates a shareholder relationship. As pointed out in appellant's opening brief, that result was legally impossible.

The Railroad Commission could not have authorized a shareholding relation with rights like those of Water Company under the agreement. But the Commission could authorize a debtor-creditor relation with those rights. No one has questioned nor can successfully question the validity of the agreement. If it be valid (and it must be), then it creates a debtor-creditor relation.

It would, indeed, be interesting to note the argument of respondent in a subsequent action involving this agreement if the one receiving the payments were not also a shareholder.

Respondent writes (p. 10): "The vendors conveyed the property to taxpayer and became the sole stockholders. The stock represented, therefore, the full value of the property conveyed". If one conveyed property solely in exchange for stock, the stock would represent the full value of the property, but if one conveyed property in exchange for stock and an obligation to pay (say \$340,000), the stock would not represent the full value of the property. In the instant case, the application of appellant to the Commission, the decision of the

Commission and the agreement of the parties specified that the 100 shares of par value of \$10,000 were to be issued as part payment. Respondent seeks to make a new agreement for the parties and, where they and the Commission had agreed and provided that the 100 shares were part payment, he would cause them to be full payment.

Both the Constitution and the Civil Code of California prohibited issuance of stock except for money paid, labor done or property received. If shares of the par value of \$10,000 had been issue for \$1,000, they would not have been fully paid and the holder could have been compelled to pay the difference between the par value and the amount actually paid. Property or cash corresponding to the par value had to be received and the whole theory underlying capital stock and shares was that the consideration received was equivalent to the par value of the shares. It is presumed that the value of a share is its par value. Especially do these principles apply to public utilities where the capital stock is important for rate making. It is clear that the parties to the agreement gave to the stock issued a value corresponding to the par value.

Respondent further writes (p. 10) "no reason appears why the properties could not have been conveyed solely for stock". That statement is not correct. A reason does appear why the properties could not have been conveyed solely for stock. The value of the properties had not been determined when the agreement was made. Until that determination was made, the amount of stock that might legally be issued could not be known. There must have been evidence before the Commission that such

value exceeded \$10,000 or it would not have made order 3773, reading [Tr. 30]:

“It is hereby ordered that Fontana Power Company be granted authority, and it is hereby granted authority, to issue one hundred (100) shares of its capital stock of the par value of One Hundred Dollars (\$100) per share to Fontana Union Water Company and Fontana Company *as part payment* for the power house site, rights of way and rights to use certain waters of Lytle Creek, in San Bernardino County.”

At pages 8 and 9 of his brief respondent cites cases in which payments were held to be distributions in the nature of dividends, although they were labeled or appeared to be something else. An equal number might be cited in which payments were held to be interest, although called dividends, or something else.

An examination of the cases referred to by respondent will show that where there was an agreement providing for payments, that agreement was considered and construed, and if it was found to create a stockholders' interest, then the distributions were held to be dividends. But respondent does not do that. Respondent, in effect, ignores the agreement in the present case and argues the payments were attributable to the holding of 100 shares, and not to the agreement.

There is no claim of tax evasion in the present case and the case should not be confused with those cases where payments were made to a stockholder under an agreement, as for salary or rent, and it is found that the payments were not *bona fide*, that is, they were not actually attributable to the debtor-creditor relation, but

were, in fact, induced by and attributable to a stockholder relation.

In any event, the agreement in the instant case was *bona fide* and it should be held by its four corners to determine the relation of the payee or payees and the payor.

Suppose a contract of a corporation disclosed an indebtedness and an agreement to pay a certain amount as interest. In case of dispute over the deductibility of the amount paid as interest, when it was admitted or established that the payment had been made pursuant to the contract, then, *prima facie*, its deductibility as interest was established. The contract would show its purpose, and would show it was paid as interest on indebtedness. To defeat deductibility in such assumed case, it would be necessary for the Commissioner to allege and prove the contract was motivated by an attempt to evade taxes and was fraudulent as to the Treasury. *Commissioner v. Van Vorst* (C. C. A. 9, 1932), 52 F. (2d) 677.

In the *Van Vorst* case, *supra*, it appeared a controlling shareholder purchased for \$54,599.60 a property that was stipulated to be worth \$100,000 more. The corporation had surplus profits of more than \$300,000, and the Commissioner contended that the value of the property over the amount paid was a distribution and that the stockholder realized income in the amount of \$100,000. Said the Court:

“There is no recital of any fact in the stipulation that is remotely suggestive of fraud or ulterior motive nor is it so contended. Counsel for petitioner, however, contend that ‘the gross inadequacy of the

consideration and the relationship of the decedent to the corporation clearly support the commissioner's determination and demonstrate that what was called a sale was in reality a distribution of assets'. If this contention is to be sustained, it must be based upon the proposition urged that, because the consideration was so inadequate and the purchaser was the principal stockholder, it should for these reasons alone be regarded as a taxable distribution. . . . In the absence of other showing the mere fact that the purchaser is a stockholder of the vending corporation does not change the character of the transaction."

In the *Van Vorst* case, the court referred to *Taplin v. Commissioner*, 41 F. (2d) 454 where a sale of stock to stockholding officers for less than 25% of its value was held not to result in income, and where the court had said respecting the Commissioner's claims:

"This is equivalent to a charge of fraud against the government and fraud is never presumed. It must be proven by clear and convincing evidence."

Respondent states the payments were not denominated "interest". True, but that is unimportant. Respondent refers to interest as compensation paid for the use of borrowed money and says no money was loaned. But interest is also paid and allowed as a deduction for income tax purposes on the numerous contracts for the sale of real and personal property.

The payments in question were made pursuant to the agreement. Such has been stipulated by counsel and necessarily found by the Board [Tr. 12]. Even respondent has written (p. 9), "The distributions in this case were made pursuant to an agreement whereby the taxpayer acquired certain properties".

That agreement created a debtor-creditor relation whereby appellant became bound to pay the balance of the reasonable value of the property appellant received. The payments in question are in the nature of compensation for delay in payment of such balance and are, therefore, interest.

Respectfully submitted,

GEO. W. HELLYER,

JOHN B. SURR,

Counsel for Appellant.

13

United States

Circuit Court of Appeals

For the Ninth Circuit.

GOLDEN STATE THEATRE & REALTY COR-
PORATION, a California corporation,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the United States
Board of Tax Appeals.

FILED

OCT - 1 1941

PAUL F. O'BRIEN,

United States
Circuit Court of Appeals
For the Ninth Circuit.

GOLDEN STATE THEATRE & REALTY COR-
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Answer	7
Appearances	1
Assignment of Errors (Board of Tax Appeals)	15
Certificate of Clerk of Board of Tax Appeals.....	37
Decision	11
Designation of Contents of Record on Review (Circuit Court of Appeals).....	38
Docket Entries	1
Notice of Filing Petition for Review.....	18
Notice of Filing Praecipe.....	36
Opinion, Memorandum	9
Order Denying Motion for Review by Entire Board	11
Order Denying Reconsideration.....	12
Petition	3
Petition for Review.....	12
Praecipe (Board of Tax Appeals).....	34
Review:	
Assignment of Errors (Board of Tax Ap- peals)	15

	Page
Designation of Contents of Record on (Circuit Court of Appeals).....	38
Petition for	12
Praceipe (Board of Tax Appeals).....	34
Statement of Points on (Circuit Court of Appeals)	38
Statement of Points on Review (Circuit Court of Appeals)	38
Stipulation of Facts.....	19
Exhibits to Stipulation of Facts:	
A—Letter dated December 5, 1939 to Golden State Theatre and Realty Corporation from Treasury Department, Internal Revenue Service	25
B—Table showing acquisition of San Francisco Wigwam Theatre by Golden State Theatre & Realty Corporation, per stock records.....	29
C—Transcript of note payable—Cecil B. DeMille Productions, Inc.....	30
D—Minutes of meeting of Board of Directors of San Francisco Wigwam Theatre Co.....	31

APPEARANCES:

For Taxpayer:

L. S. HAMM, Esq.,

B. E. KRAGEN,

ADRIAN A. KRAGEN, Esq.

LIONEL B. BENAS, Esq.

For Comm'r:

ARTHUR L. MURRAY.

Docket No. 101526

GOLDEN STATE THEATRE AND REALTY
CORPORATION, a California Corporation,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Entries

1940

Feb. 21—Petition received and filed. Taxpayer notified. (Fee paid).

Feb. 21—Copy of petition served on General Counsel.

Feb. 21—Request for circuit hearing in San Francisco, Calif., filed by taxpayer. 2/21/40 copy served.

Mar. 26—Answer filed by General Counsel.

Mar. 29—Copy of answer served on taxpayer. San Francisco, Calif., Calendar.

1940

Aug. 13—Hearing set Oct. 7, 1940.

Oct. 15—Hearing had before Mr. Sternhagen on merits. Submitted. Stipulation of facts and appearance of Lionel B. Benas, Esq., filed. Petitioner's brief due 11/14/40; Respondent's 12/14/40; Reply 1/3/41.

Nov. 12—Transcript of hearing of Oct. 15, 1940, filed.

Nov. 13—Brief filed by taxpayer. 11/14/40 copy served on General Counsel.

Nov. 28—Motion for extension to Jan. 14, 1941 to file brief filed by General Counsel. 11/28/40 granted.

1941

Jan. 14—Reply brief filed by General Counsel.

Feb. 3—Reply brief filed by taxpayer. 2/3/41 copy served on General Counsel.

Mar. 28—Memorandum opinion rendered, Sternhagen, Div. 10. Decision will be entered for the respondent.

Mar. 28—Decision entered, Sternhagen, Div. 10.

Apr. 28—Motion for consideration and review by entire Board and in the alternative that a rehearing be granted to the petitioner, filed by taxpayer.

Apr. 29—Order denying review by the Full Board and insofar as the motion for reconsideration and rehearing is referred to Division #10 for action, entered. [1*]

*Page numbering appearing at foot of page of original certified Transcript of Record.

1941

- May 3—Order denying Board review, entered.
July 16—Petition for review by United States Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.
July 16—Proof of service filed by taxpayer.
Aug. 4—Praecipe for transcript filed by taxpayer—proof of service thereon.
Aug. 4—Proof of service filed by taxpayer. [2]
-

United States Board of Tax Appeals

Docket No. 101526

GOLDEN STATE THEATRE & REALTY CORPORATION, a California corporation,
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, San Francisco Division, IRA:90-D DCE, dated December 5, 1939, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under and by virtue of the laws of the

State of California and having its office and principal place of business at No. 25 Taylor Street, at the City and County of San Francisco in said state. The return for the period here involved was filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner [3] on December 5, 1939.

3. The taxes in controversy are income and undistributed profits taxes for the calendar year 1936 and the amount in question is the sum of \$13,277.09, being a portion of a total asserted deficiency in the sum of \$15,562.51.

4. The determination of taxes set forth in the notice of deficiency is based upon the following errors:

(a) The determination that there was received from San Francisco Wigwam Theatre Co., a California corporation and a wholly owned and fully controlled subsidiary of Golden State Theatre & Realty Corporation, likewise a California corporation, petitioner herein, 4397 shares of the capital stock of said petitioner and that said alleged receipt is taxable to petitioner as a dividend under the provisions of Section 115 (a) and (j) of the Revenue Act of 1936.

(b) The determination that said 4397 shares of petitioner's capital stock were of a value to petitioner, at the date of said alleged receipt, of \$65,295.45.

(c) The determination that said 4397 shares of petitioner's capital stock was not Treasury stock of petitioner while in the hands of San Francisco Wigwam Theatre Co., a wholly owned and fully controlled subsidiary.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows: [4]

(a) On July 8, 1931, petitioner herein, Golden State Theatre & Realty Corporation, owned and held of record all of the issued and outstanding capital stock of San Francisco Wigwam Theatre Co. and ever since said date has been and now is the owner and record holder thereof. During the period of time commencing on July 8, 1931 and continuing through October 2, 1931, San Francisco Wigwam Theatre Co. acquired 4397 shares of the capital stock of petitioner, the parent corporation which stock was purchased by San Francisco Wigwam Theatre Co. for cash from persons other than petitioner.

(b) From the time of its acquisition by said San Francisco Wigwam Theatre Co., said 4397 shares of stock, and all of it, was Treasury stock of said Golden State Theatre & Realty Corporation and had no value to petitioner during any of said period and was not an asset of any value to petitioner since the date hereinabove mentioned, or during any of said period.

Wherefore, petitioner prays that this Board may hear the proceeding and determine that there was no dividend from San Francisco Wigwam Theatre Co. to petitioner and that the capital stock of peti-

tioner held by San Francisco Wigwam Theatre Co. was at all times since July 8, 1931, Treasury stock of petitioner and of no value to it; and for such other and further relief as may be meet and proper in the [5] premises.

L. S. HAMM

B. E. KRAGEN

ADRIAN A. KRAGEN

Counsel for Petitioner

713 Loew's Warfield Building
San Francisco, California.

State of California

City and County of San Francisco.—ss.

E. H. Emmick, being duly sworn, says that he is an officer, to-wit, the president, of petitioner and that he is duly authorized to verify the foregoing petition; that he has read said petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

E. H. EMMICK

Subscribed and sworn to before me this 15th day of February, 1940.

(Seal)

RUTH H. COSGROVE

Notary Public In and for the City and County of
San Francisco, State of California.

[For Ex "A" See Ex. "A" Attached Stip.
of Facts.]

[Endorsed]: U. S. B. T. A. Filed Feb. 21, 1940.

[6]

[Title of Board and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits that the notice of deficiency was mailed to the petitioner on December 5, 1939; denies that a complete copy of the notice of deficiency is attached to the petition as alleged in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1936; denies the remaining allegations contained in paragraph 3 of the petition.

4 (a) to (c), inclusive. Denies that the determination [7] of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 and subparagraphs (a) to (c) thereunder of the petition.

5(a). Admits that the petitioner owns all the issued and outstanding capital stock of San Francisco Wigwam Theatre Co., and that during the period of time commencing July 8, 1931, and continuing through October 2, 1931, said San Francisco Wigwam Theatre Co. acquired 4,397 shares of capi-

tal stock of petitioner; for lack of information, and for other reasons, denies the remaining allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b). Denies the allegations contained in subparagraph (b) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

(Signed) J. P. WENCHEL

TMM

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD

T. M. MATHER,

ARTHUR L. MURRAY,

Special Attorneys,

Bureau of Internal Revenue.

ALM:sob 3/18/40

[Endorsed]: U. S. B. T. A. Filed Mar. 26, 1940.

[8]

[Title of Board and Cause.]

Lional B. Benas, Esq., for the petitioner.

Arthur L. Murray, Esq., for the respondent.

MEMORANDUM OPINION

Sternhagen: The Commissioner determined a deficiency of \$15,562.51 in petitioner's income tax for 1936. The facts are found as stipulated.

Petitioner is a California corporation doing business in San Francisco. In the taxable year it owned all of the shares of San Francisco Wigwam Theatre Co. As a result of purchases made in 1931, the Wigwam corpora- [9] tion acquired 5,030 shares of petitioner's stock. Of these, 633 shares were transferred in that year to Bolton. The remaining 4,397 shares were held by the Wigwam corporation until 1936 and then transferred to petitioner pursuant to a resolution of the Wigwam directors. The transfer was regarded by the directors as a "donation," and was charged by the Wigwam corporation to earned surplus. The value of the 4,397 shares when transferred in 1936 was \$65,295.45.

The Commissioner held that this amount was taxable to petitioner as a dividend under Revenue Act of 1936, section 115 (a) and (j). The petitioner contests this and constructs its argument upon the unity of the two corporations in view of the petitioner's complete ownership of the Wigwam shares. It treats the 4,397 shares owned by Wigwam as if they were treasury stock of petitioner and, under the California Civil Code, section 342, not to be

regarded as outstanding or as an asset available for dividends. This conception of unity of the two corporations is not now permissible, since Congress, by discontinuing the recognition of consolidated returns, has required the treatment of separate corporations separately, irrespective of affiliation. This is sufficient to overcome any possible reasoning to be derived from *Southern Pacific Co. v. Lowe*, 247 U. S. 330, and *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71, upon which petitioner heavily relies. Irrespective of whether the petitioner's shares when owned by the Wigwam corporation could be regarded for purposes of California law as treasury stock, this would be irrelevant to the application of the Federal revenue.

For the purpose of the present decision it is enough that this was a distribution by the Wigwam corporation to petitioner, its shareholder, which, so far as the record shows, was within the **statutory** definition of dividend, the value of which is not disputed.

Enter:

Decision will be entered for the respondent.

Entered Mar. 28, 1941. [10]

United States Board of Tax Appeals
Washington

Docket No. 101526

GOLDEN STATE THEATRE & REALTY COR-
PORATION,

Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

In accordance with the Board's Memorandum Opinion, entered March 28, 1941, it is

Ordered and decided that there is a deficiency of \$15,562.51 in income tax for 1936.

Enter:

(Seal)

(S) J. M. STERNHAGEN

Member [11]

[Title of Board and Cause.]

ORDER DENYING REVIEW BY THE BOARD

On April 28, 1941, petitioner filed a motion in respect of the Memorandum Opinion of Division No. 10 (Sternhagen) entered March 28, 1941, asking for reconsideration; review by the entire Board; and in the alternative for a rehearing. The motion insofar as it asks for review by the entire Board

has been given careful consideration and it is not believed that it should be granted. Accordingly, the motion for review by the entire Board is hereby denied.

The motion insofar as it asks for reconsideration and a rehearing is referred to Division No. 10 (Sternhagen) for action.

(Seal) (Signed) C. R. ARUNDELL,
Chairman.

April 29, 1941. [12]

[Title of Board and Cause.]

ORDER DENYING RECONSIDERATION

The motion filed by the petitioner on April 28, 1941, for reconsideration is denied.

(Seal) (Signed) J. M. STERNHAGEN,
Member.

May 3, 1941. [13]

[Title of Board and Cause.]

PETITION FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Cir-
cuit:

Golden State Theatre & Realty Corporation, pe-
titioner herein, herewith files this, its petition for

review by the United States Circuit Court of Appeals for the Ninth Circuit, of a decision of the United States Board of Tax Appeals entered on March 28, 1941, finding a deficiency in income tax in the amount of \$15,562.51, payable by petitioner for the year 1936, together with an order denying review of said decision by the entire Board, made on April 29, 1941 and an order denying reconsideration thereof made on May 3rd, 1941, and respectfully shows:— [14]

I.

Petitioner is a corporation organized and existing under the laws of the State of California and having its principal office and place of business at No. 995 Market Street, at the City and County of San Francisco, in said State. The return of income tax in respect of which the aforementioned liability arose was filed by petitioner with the Collector of Internal Revenue for the First District of California, which is located within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

II.

The respondent determined an income tax deficiency against petitioner for the taxable year ended December 31, 1936, from which assessment petitioner appealed to the United States Board of Tax Appeals, seeking a redetermination thereof and asserting error. The decision of the United States Board of Tax Appeals sustained the respondent and

said decision was entered by said Board on March 28, 1941. Petitioner filed a motion for review by the entire Board, which was denied on April 29, 1941, and filed a motion for reconsideration, which was denied on May 3, 1941.

III.

Petitioner has been engaged in the theatre business in the City and County of San Francisco and elsewhere in the State of California, for approximately fifteen years last [15] past and immediately preceding the year 1936. San Francisco Wigwam Theatre Co. is also a California corporation with its principal place of business at San Francisco, California. Both of these corporations were in existence during all of the times herein referred to. In the year 1931 and continuously up to and including the present time, petitioner owned all of the issued and outstanding capital stock of San Francisco Wigwam Theatre Co., and during said period of time San Francisco Wigwam Theatre Co. was and is a wholly owned and controlled subsidiary of petitioner.

During the year 1931, said San Francisco Wigwam Theatre Co. acquired by purchase from outside parties 4397 shares of the capital stock of petitioner. Certificates evidencing these shares were issued to and in the name of said San Francisco Wigwam Theatre Co. and so stood of record, continuously, until December 15, 1936. On May 12, 1936, the Board of Directors of San Francisco Wig-

wam Theatre Co. by resolution authorized the transfer of said 4397 shares by the subsidiary to the parent, petitioner herein, and on December 15, 1936, the transfer was made and new certificates evidencing said shares were issued in the name of petitioner.

The value of the shares at the time of their transfer to petitioner was \$65,295.15 and respondent held that this amount was taxable to petitioner as a dividend under sections 115(a) and 115(j) of the Revenue Act of 1936. Petitioner contended that this was not a taxable dividend because [16] the 4397 shares of petitioner's stock held by San Francisco Wigwam Theatre Co. was treasury stock of petitioner and in receiving its own stock petitioner received nothing of value to itself.

The Board of Tax Appeals held: That there was a distribution by San Francisco Wigwam Theatre Co. to petitioner, its shareholder, which was within the statutory definition of a dividend.

IV.

In making its decision as aforesaid, the United States Board of Tax Appeals committed the following errors upon which the petitioner relies as the basis of this proceeding:

1. The Board erred in the determination that there was received from San Francisco Wigwam Theatre Co., a California corporation and a wholly owned and fully controlled subsidiary of Golden State Theatre & Realty Corporation, likewise a Cali-

fornia corporation, petitioner herein, 4397 shares of the capital stock of petitioner and that said alleged receipt is taxable to petitioner as a dividend under the provisions of sections 115(a) and 115(j) of the Revenue Act of 1936.

2. The Board erred in the determination that said 4397 shares of petitioner's capital stock were of a value to petitioner, at the date of said alleged receipt, of \$65,295.45.

3. The Board erred in the determination that said [17] 4397 shares of petitioner's capital stock were not treasury stock of petitioner while in the hands of San Francisco Wigwam Theatre Co., a wholly owned and fully controlled subsidiary.

4. The Board erred in concluding that provisions of California law under which shares of the stock of a parent corporation held by a wholly owned and controlled subsidiary may be regarded as treasury stock, are irrelevant to the application of the Federal Revenue Act.

5. The Board erred in its conclusion that because Congress has discontinued the recognition of consolidated returns, the unity of the two corporations in view of petitioner's complete ownership of the stock of San Francisco Wigwam Theatre Co. cannot be considered.

6. The Board erred in determining income tax deficiency for the year 1936 in the sum of \$15,562.51.

7. The Board erred in not ordering and deciding in favor of petitioner and against respondent.

Wherefore, your petitioner prays that this Hon-

orable Court review the decision and order of the United States Board of Tax Appeals and reverse and set aside the same and direct the said Board to enter a decision in favor of petitioner, determining that there is no deficiency in income tax for the year 1936 due from petitioner; and for the entry of such further orders and directions as shall by this Court [18] be deemed meet and proper, in accordance with law.

L. S. HAMM,

B. E. KRAGEN,

Attorneys for Petitioner.

Address: 713 Loew Building, San Francisco, California.

[Endorsed]: U.S.B.T.A. Filed July 16, 1941.

[18a]

State of California

City and County of San Francisco—ss.

L. S. Hamm, being duly sworn, says:—

I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. This petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

L. S. HAMM.

Subscribed and sworn to before me this 9th day of July, 1941.

(Seal) RUTH H. COSGROVE,
Notary Public in and for the City and County of
San Francisco, State of California.

My Commission expires August 16, 1943. [19]

[Title of Board and Cause.]

NOTICE OF FILING PETITION FOR RE-
VIEW AND ACCEPTANCE OF SERVICE
THEREOF

To:

Commissioner of Internal Revenue
Internal Revenue Building
Washington, D. C.

Hon. J. P. Wenchel, Attorney for Respondent
Chief Counsel
Bureau of Internal Revenue
Internal Revenue Building
Washington, D. C.

You are hereby notified that on the 16th day of July, 1941, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of the Board.

A copy of the petition as filed is attached hereto and served upon you.

Dated July 9, 1941.

(S) L. S. HAMM

(S) B. E. KRAGEN

Attorney for Petitioner.

Address: 713 Loew Building, San Francisco, California. [20]

Personal service of the foregoing notice of filing and a copy of the petition for review is hereby acknowledged this 16th day of July, 1941.

(S) J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

[Endorsed]: U.S.B.T.A. Filed July 16, 1941.

[21]

[Title of Board and Cause.]

STIPULATION

It Is Hereby Stipulated and agreed by and between the parties hereto, by their respective counsel of record, that this stipulation shall be received in evidence at the trial of the above entitled proceeding and shall be sufficient evidence of the truth of each and every statement made therein; except that any of the parties to said proceeding may, at the trial thereof, offer any additional competent and relevant

evidence, not inconsistent with the facts herein stipulated.

1. It is stipulated that the tax in controversy is income tax for the calendar year 1936 and the amount in question is the sum of \$13,276.99, being a portion of a total asserted deficiency in the sum of \$15,562.51. [22]

2. It is stipulated that although by inadvertence a complete copy of the notice of deficiency was not attached to the petition filed herein, a full and complete copy of said notice of deficiency may be and the same is attached to this stipulation, marked Exhibit "A" and made a part hereof.

3. It is stipulated that petitioner Golden State Theatre & Realty Corporation is a California corporation having its principal place of business at No. 25 Taylor Street in the City and County of San Francisco, State of California.

4. It is stipulated that San Francisco Wigwam Theatre Co. is a California corporation with its principal place of business at No. 25 Taylor Street, San Francisco, California.

5. It is stipulated that at the dates and times of the transactions hereinafter set forth, to-wit, in the year 1931 up to and including the present time, petitioner Golden State Theatre & Realty Corporation owned all of the issued and outstanding capital stock of San Francisco Wigwam Theatre Co. and that during all of said period and at the present time San Francisco Wigwam Theatre Co. was and is a wholly owned subsidiary of petitioner Golden

State Theatre & Realty Corporation; that a statement of the dates and times at which Golden State Theatre & Realty Corporation acquired the said stock of San Francisco Wigwam Theatre Co. is hereto attached, marked Exhibit "B" and made a part hereof. [23]

6. It is stipulated that on July 8, 1931, 2500 shares of the capital stock of petitioner Golden State Theatre & Realty Corporation were purchased from Victoria Mariani and on July 8, 1931, by check No. 9262 of the San Francisco Wigwam Theatre Co., she was paid the sum of \$5000 and on July 8, 1931, by check No. 9264 of the San Francisco Wigwam Theatre Co., she was paid the sum of \$20,000.

7. It is stipulated that on October 2, 1931, 2530 shares of the capital stock of petitioner Golden State Theatre & Realty Corporation were purchased from Cecil B. DeMille Productions, Inc. for a total sum of \$30,935 and that said sum was paid in forty-nine installments on the dates and in accordance with the schedule attached hereto, marked Exhibit "C" and made a part hereof; that each of the checks issued and as numbered in Exhibit "C" were checks of the San Francisco Wigwam Theatre Co.

8. It is stipulated that on October 2, 1931, 633 shares of said Golden State Theatre & Realty Corporation stock was transferred by San Francisco Wigwam Theatre Co., to David Bolton for the sum of \$7,733.75, and the General Journal of the San

Francisco Wigwam Theatre Co., at page 57 shows the following entry:—

	Debit	Credit
"Accts Receivable Dave Bolton	7733.75	
To Stocks and Bonds		7733.75
Sale 633 shares Capital Stock		
Golden State T & R Corp upon the same		
terms as above purchase."		

[24]

9. It is stipulated that on September 30, 1931, R. A. McNeil, a Vice President of the Golden State Theatre & Realty Corporation, was paid a commission of \$2500.00 by San Francisco Wigwam Theatre Co., in connection with the purchase of stock by San Francisco Wigwam Theatre Co., from Victoria Mariani as described in paragraph 6 above. That on January 18, 1937, the said R. A. McNeil refunded the sum of \$2500.00 by paying the said sum to the Golden State Theatre & Realty Corporation, and said amount was credited to the earned surplus account of the Golden State Theatre & Realty Corporation.

10. It is stipulated that the cost of said 4,397 shares of capital stock of Golden State Theatre & Realty Corporation, which were paid for by San Francisco Wigwam Theatre Co., was \$50,701.25. This cost included the said commission of \$2,500 paid by the San Francisco Wigwam Theatre Co. to R. A. McNeil.

11. It is stipulated that stock certificates representing 4397 shares of the Capital Stock of Golden State Theatre & Realty Corporation purchased from Victoria Mariani and Cecil B. DeMille Productions,

Inc., referred to in paragraphs 6, 7, 8 and 10 were cancelled on October 8, 1931, and new certificates were issued on the same day in the name of San Francisco Wigwam Theatre Co. That the said certificates in the name of San Francisco Wigwam Theatre Co., were cancelled on December 15, 1936, and new certificates issued on said date in the name of Golden State Theatre & Realty Corporation.

It is further stipulated that the aforesaid 4397 shares of stock acquired as referred to in paragraphs 6, 7, 8 and 10 were carried as a debit in the Stocks and Bonds Account of [25] the San Francisco Wigwam Theatre Co., until December 31, 1936; that on December 31, 1936, a charge of \$50,701.25 was made to the earned surplus account of the San Francisco Wigwam Theatre Co., and a corresponding credit made in the stocks and bonds account of San Francisco Wigwam Theatre Co.; that on January 18, 1937, \$2500.00 representing the refund of the commission paid to R. A. McNeil, was credited to the earned surplus account of petitioner, Golden State Theatre & Realty Corporation.

12. It is stipulated that the following entries were made on the books of the Golden State Theatre & Realty Corporation relative to the transfer of the aforesaid stock:

	Debit	Credit
"Journal page 4001—		
4-3-37		
Treasury Stock	\$43,970.00	
To Capital Surplus		\$43,970.00
4397 shares of G S owned by		
S F Wigwam Theatre Co.		
Donated"		

EXHIBIT "A"

Treasury Department
Internal Revenue Service
433 Federal Office Building
San Francisco, California
Dec. 5 1939

Office of Internal Revenue Agent in Charge San
Francisco Division.

IRA:90-D

DCE

Golden State Theatre & Realty Corporation,
25 Taylor Street,
San Francisco, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1936, discloses a deficiency of \$15,-562.51 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San

Francisco, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By F. M. HARLESS

Internal Revenue Agent in
Charge.

H.J.B.

Enclosures:

Statement.

Form of waiver. [28]

STATEMENT

San Francisco

IRA:90-D

DCE

Golden State Theatre & Realty Corporation,
25 Taylor Street,
San Francisco, California.

Tax Liability for the Taxable Year Ended December 31, 1936.

Income Tax

Liability—\$50,416.34

Assessed—\$34,953.83

Deficiency—\$15,562.51

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated December 16, 1938; to your protest dated January 25, 1939; to the statements made at the conferences held on March 22 and June 15, 1939.

Adjustments to Net Income

Net income as disclosed by line 27 page 2 of return	\$301,395.69
Unallowable deductions and additional income:	
(a) Dividends—cash	\$11,240.00
(b) Dividends—Property	65,295.45 76,535.45
Net income adjusted	\$377,931.14

EXPLANATION OF ADJUSTMENTS

(a) These dividends were from corporations as follows:	
North Beach Theatre Company.....	\$ 1,140.00
East Bay Theatre Company.....	3,000.00
Hollister Golden State Theatre Company.....	5,100.00
Republic Theatre Company.....	2,000.00
	<hr/>
	\$11,240.00
	[29]

Journal entries as at December 31, 1935, represent these dividends as accounts receivable. As the available evidence indicates that these dividends were not declared or available to the stockholders in 1935 and were actually paid or distributed in 1936, they are included in income from dividends for 1936.

(b) It is held that the 4,397 shares of your stock received from the San Francisco Wigwam Theatre

Company, a fully controlled subsidiary, had a value at the date of receipt of \$65,295.45 and that it is taxable to you as a dividend under the provisions of Section 115(a) and (j) of the Revenue Act of 1936.

COMPUTATION OF TAX

Excess-profits Tax:

Taxable net income\$377,931.14

Less:

Dividends received credit (85% of
\$269,684.45)\$229,231.78

10% of \$2,500,000.00 value of capital stock as declared in your capital stock tax return for year ended June 30, 1936. 250,000.00 479,231.14

Net income subject to excess-profits tax..... none

Total excess-profits tax..... none

Income Tax:

Normal Tax:

Taxable net income for normal tax computation.....\$377,931.14

Less:

(85% of dividends received from taxable domestic corporations) 229,231.78

Normal tax net income.....\$148,699.36

[30]

8% of \$ 2,000.00 (Over \$ 0 to \$ 2,000).....\$ 160.00

11% of \$ 13,000.00 (Over \$ 2,000 to \$15,000)..... 1,430.00

13% of \$ 25,000.00 (Over \$15,000 to \$40,000)..... 3,250.00

15% of \$108,699.36 (Over \$40,000)..... 16,304.90

Total normal Tax\$ 21,144.90

Surtax on Undistributed Profits:

Taxable net income \$377,931.14

Less:

Normal tax 21,144.90

Adjusted net income \$356,786.24

Less:

Dividends paid credit 166,972.75

Undistributed net income \$189,813.49

7% of \$35,678.62.....\$ 2,497.50

12% of \$35,678.62..... 4,281.43

17% of \$71,357.25..... 12,130.73

22% of \$47,099.00..... 10,361.78

Total surtax\$ 29,271.44

Normal tax 21,144.90

Total income tax (normal tax and surtax).....\$ 50,416.34

Income tax assessed (normal tax and surtax):

Original, account No. 401579—First California..... 34,853.83

Deficiency of income tax.....\$ 15,562.51

[31]

EXHIBIT "B"

ACQUISITION OF SAN FRANCISCO WIGWAM THEATRE
CO. BY GOLDEN STATE THEATRE & REALTY COR-
PORATION. PER STOCK RECORDS.

Date Acquired	Shares
Sept. 19, 1928.....	87
Mar. 7, 1929.....	43
Dec. 18, 1929.....	87
Dec. 18, 1929.....	341
Jan. 2, 1930.....	130

688 Fully owned prior to July 8, 1931.

Ledger shows this at \$68,700.00.

[32]

EXHIBIT "C"

San Francisco Wigwam Theatre Co.

TRANSCRIPT OF NOTE PAYABLE—CECIL B. DEMILLE
PRODUCTIONS, INC.

Date	Item	Folio	Dr.	Cr.
Oct. 2, 1937	2530 shares G. S. T. & R. stock (Cost 12.22728 ea.) Int. 6%—Cash 20% 48 pay- ments	J 57		30,935.00
	Ck. No.			
Oct. 10, 1931	9521	AP. 637	6,187.00	
Nov. 9	9630	348	515.59	
Dec. 8	9750		515.59	
Jan. 8, 1932	9897	368	515.59	
Feb. 8	16		515.59	
March 8	130	384	515.59	
April 8	288		515.59	
May 9	410	404	515.59	
June 8	541		515.59	
July 8	648		515.59	
August 8	683		515.59	
Sept. 8	706		515.59	
Oct. 8	723	429	515.59	
Nov. 8	732		515.59	
Dec. 8	743		515.59	
Jan. 9, 1933	754	433	515.59	
Feb. 7	762	—	515.59	
March 13	767	434	515.59	
April 7	773	435	515.59	
May 8	780		515.59	
June 6	787	436	515.59	
July 8	796	437	515.59	
Aug. 8	801		515.59	
Sept. 8	805	438	515.59	
Oct. 9	812		515.59	
Nov. 9	816	439	515.59	
Dec. 7	824	440	515.59	

Date	Ck. No.	Folio	Dr.	Cr.
Jan. 8, 1934	828	441	515.59	
Feb. 8	833		515.59	
March 8	841	442	515.59	
April 9	846		515.59	
May 7	850	443	515.59	
June 7	853		515.59	
[33]				
July 9, 1934	857		515.59	
August 8	862	444	515.59	
Sept. 6	866		515.59	
Oct. 6	869	445	515.59	
Nov. 8	874	CD/1	515.59	
Dec. 29	878	CD/2	515.59	
Jan. 8, 1935	881	CD/1	515.59	
Feb. 8	886	CD/1	515.59	
Mar. 8	890		515.59	
Apr. 8	899	CD/2	515.59	
May 8	916	CD/3	515.59	
June 6	954	CD/4	515.59	
July 8	968	CD/5	515.59	
Aug. 8	980	CD/5	515.59	
Sept. 8	989	CD/5	515.59	
Oct. 8	1001	CD/1	515.27	
			<hr/>	<hr/>
			30,935.00	30,935.00
[34]				

EXHIBIT "D"

MINUTES OF MEETING OF BOARD OF DIRECTORS

Pursuant to the by-laws and to the call of the president at the annual shareholders meeting just held, a meeting of the newly elected Board of Directors of San Francisco Wigwam Theatre Co. was

held at the office of the corporation, No. 25 Taylor Street, San Francisco, California, at 11:30 o'clock on the morning of Tuesday, May 12, 1936. All Directors were present. Director Emmick took the chair and appointed L. S. Hamm to act as secretary of the meeting.

The chair stated that the first business is the election of officers and called for nominations for president. Director Emmick was nominated and as there were no further nominations he was declared duly elected and qualified. In like manner M. Naify was elected vice president, R. A. McNeil was elected treasurer and L. S. Hamm was elected secretary. The board then appointed Hazel Watson an assistant secretary to serve during the pleasure of the board and to have powers and duties commensurate with those of the secretary, in the absence of the latter.

The president then stated that with the advice and approval of the directors a new agreement of joint venture had been entered into by this corporation with a subsidiary corporation of Fox West Coast Theatres whereby the operations of the El Capitan Theatre and the operations of the Rialto Theatre, [35] the latter being owned by this corporation, are being carried on by Fox West Coast. The new agreement, which has the effect of cancelling a prior agreement, was presented and read to the board and, upon motion of Director McNeil, seconded by Director M. Naify, its execution was ratified and approved.

The president then stated that this corporation is the owner of 4397 shares of the capital stock of Golden State Theatre & Realty Corporation, which last named corporation owns all of the issued and outstanding stock of this corporation, with the exception of the qualifying shares held by the directors. He stated that in his opinion it is advisable for this corporation to donate said 4397 shares of stock of said Golden State company to the latter corporation and he asked the consideration of the directors with respect to the proposal. Upon motion of Director M. Naify, seconded by Director McNeil, the following resolution was then passed without dissenting voice:

Resolved, that this corporation convey to Golden State Theatre & Realty Corporation 4397 shares of the stock of the last named corporation now owned by this corporation and that if in the judgment of this corporation's accountant said transaction should be so handled, said conveyance be by way of a donation made by this corporation to said Golden State Theatre & Realty Corporation.

Upon motion of Director M. Naify, seconded by Director J. A. Naify, the corporation is authorized to open a bank account with The Anglo California National Bank of San Francisco, Jones and Market Branch, and withdrawals were authorized upon [36] the single and separate signature of E. H. Emmick, M. Naify, J. A. Naify and R. A. McNeil.

The president then requested the secretary to read the names of those persons who are now the officers and directors of the corporation. They were read and are as follows:

President and Director	E. H. Emmick
Vice President and Director	M. Naify
Treasurer and Director	R. A. McNeil
Director	J. A. Naify
Secretary	L. S. Hamm
Assistant Secretary	Hazel Watson

There being no further business to come before the board, the meeting adjourned, subject to call.

L. S. HAMM

Secretary

[Endorsed]: U. S. B. T. A. Filed at hearing Oct. 15, 1940. [37]

[Title of Board and Cause.]

PRAECIPE FOR TRANSCRIPT

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of

Appeals for the Ninth Circuit, heretofore filed by the above-named petitioner:—

1. Docket entries of the proceedings before the Board.

2. Petition filed on February 21, 1940.

3. Answer to petition filed on March 26, 1940.

4. Findings of Fact and opinion of the Board, promulgated on March 28, 1941.

5. Order denying motion for review by entire Board entered on April 29, 1941. [38]

6. Order denying reconsideration entered on May 3, 1941.

7. Petition for review filed on July 16, 1941.

8. Notice of filing petition for review filed on July 16, 1941.

9. Stipulation of Facts and exhibits attached thereto, filed on October 15, 1940.

10. Orders enlarging time for transmission and delivery of documents.

11. This Praecept for Record.

12. Notice of filing this Praecept for Record and the admission of service thereof.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

L. S. HAMM

B. E. KRAGEN

Attorneys for Petitioner.

Service of a copy of this Praeceptum is hereby admitted this 4th day of August, 1941.

(S) J. P. WENCHEL

Chief Counsel

Bureau of Internal Revenue

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed Aug. 4, 1941.

[39]

[Title of Board and Cause.]

To: The Hon. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Internal Revenue Building, Washington, D. C.

Please take notice that on the 4th day of August, 1941, the undersigned, attorneys for Golden State Theatre & Realty Corporation, the petitioner in the above entitled proceeding, has filed with the Clerk of the United States Board of Tax Appeals a Praeceptum for Record, a copy of which is annexed hereto.

L. S. HAMM

B. E. KRAGEN

Attorneys for Petitioner.

Dated: August 4, 1941. [40]

Receipt of the foregoing Notice of Filing the Praeceptum for Record and service of a copy of the

Praecipe herein mentioned is acknowledged this 4th day of August, 1941.

J. P. WENCHEL

Chief Counsel

Bureau of Internal Revenue

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed Aug. 4, 1941.

[41]

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 41, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 15 day of Aug. 1941.

B. D. GAMBLE

Clerk,

United States Board of Tax
Appeals.

[Endorsed]: No. 9902. United States Circuit Court of Appeals for the Ninth Circuit. Golden State Theatre & Realty Corporation, a California corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed August 29, 1941.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals

For the Ninth Circuit

No. 9902

GOLDEN STATE THEATRE & REALTY COR-
PORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

To the Clerk of the Above Entitled Court:

You will please take notice that pursuant to subdivision 6 of Rule 19 of the above entitled Court petitioner above named desires to adopt as its points on appeal the assignments of error included

in the petition for review within the transcript of record in said matter and further that the record as certified to you by the Board of Tax Appeals be printed in its entirety.

Respectfully,

L. S. HAMM

B. E. KRAGEN

Attorneys for Petitioner.

[Endorsed]: Filed Sept. 5, 1941. Paul P. O'Brien,
Clerk.

14
No. 9902

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GOLDEN STATE THEATRE & REALTY COR-
PORATION (a California corporation),
Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

L. S. HAMM,

B. E. KRAGEN,

Loew Building, San Francisco,

LIONEL B. BENAS,

Latham Square Building, Oakland,

Attorneys for Petitioner.

JESSE FELDMAN,

Loew Building, San Francisco,

Of Counsel.

FILED

OCT 22 1941

PAUL P. O'BRIEN,
CLERK

Subject Index

	Page
Statement of Basis of Original and Appellate Jurisdiction..	1
Statement of the Case and Question Involved.....	2
Specification of Errors.....	3
Summary of the Evidence.....	4
Summary of Argument	6
Argument	6
I. The Transfer Involved Was Not a Transfer of Value	6
II. The Substance and not Form Should Be Determinative of the Application of the Taxing Act.....	16

Table of Authorities Cited

Cases	Pages
Bender v. Pfaff (1930), 282 U. S. 127, 51 S. Ct. 64.....	12
Blair v. Commissioner (1937), 300 U. S. 5, 57 S. Ct. 330....	14, 15
Borg v. International Silver Co. (1925), 11 F. (2d) 147..	9
Cannon v. Nicholas (1935), 80 F. (2d) 934.....	13
Commissioner v. Woods Machinery Co. (1932), 57 F. (2d) 635	17
Goodell v. Koch (1930), 282 U. S. 118, 51 S. Ct. 62.....	12
Hopkins v. Bacon (1930), 282 U. S. 122, 51 S. Ct. 62.....	12
Labrot v. Burnet (1932), 57 F. (2d) 413.....	16
Lang v. Commissioner (1938), 304 U. S. 264, 58 S. Ct. 880..	12, 13
Morgan v. Commissioner (1940), 309 U. S. 75, 60 S. Ct. 424	10, 11, 12
Poe v. Seaborn (1930), 282 U. S. 101, 51 S. Ct. 58.....	12
Robert P. Hyams Co., Inc. v. United States (1928), 26 F. (2d) 805	17
Tooley, Executor v. Commissioner (1941), 121 F. (2d) 350	13
United States v. Malcolm (1931), 282 U. S. 792, 51 S. Ct. 184	12

Statutes

Civil Code of California (1935):	
Sec. 342	7, 8
Sec. 342a	7, 8
Sec. 342b	7, 8
Revenue Act of 1924, C. 234, Sec. 900 (e), as amended, 43 Stat. 336, as amended.....	1
Revenue Act of 1926, C. 27, Secs. 1001-1003, as amended, 44 Stat. 9, 109-110, as amended.....	1
Revenue Act of 1936, Sec. 115 (a).....	2, 3, 5
Revenue Act of 1936, Sec. 115 (j).....	2, 3, 5, 10

Regulations

U. S. Treasury Department Regulations 94:	
Art. 22(a)-1	10
Art. 115-3	17

No. 9902

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GOLDEN STATE THEATRE & REALTY COR-
PORATION (a California corporation),

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

STATEMENT OF BASIS OF ORIGINAL AND APPELLATE JURISDICTION.

The jurisdiction of the United States Board of Tax Appeals is based upon the provisions of C. 234, Section 900 (e) of the Revenue Act of 1924, 43 Stat. 336, as amended, giving said Board jurisdiction of cases in which the Commissioner of Internal Revenue has determined deficiencies in income and other tax matters. The jurisdictional facts are alleged in the petition filed with the United States Board of Tax Appeals. (Tr. pp. 3-6.)

The jurisdiction of this Honorable Court is based upon Sections 1001-1003 of the Revenue Act of 1926,

C. 27, 44 Stat. 9, 109-110, as amended, providing for the review of the Board decisions by the Circuit Court.

Petitioner's returns during all the years in question were filed by petitioner with the Collector of Internal Revenue for the First District of California, the office of said district being located within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit. (Tr. p. 13.)

STATEMENT OF THE CASE AND QUESTION INVOLVED.

This appeal involves income taxes for the calendar year 1936 and said appeal is taken from a judgment of the Board of Tax Appeals holding adversely to petitioner with respect to a petition to redetermine income tax deficiencies found by the Commissioner of Internal Revenue. The case is brought before this Court by petition for review filed July 16, 1941. (Tr. p. 12.) The question presented is whether or not the Board of Tax Appeals erred in determining that there was received from San Francisco Wigwam Theatre Co., a wholly owned subsidiary of Golden State Theatre & Realty Corporation, likewise a California corporation, petitioner herein, 4397 shares of the capital stock of petitioner as a taxable dividend under the provisions of Section 115 (a) and (j) of the Revenue Act of 1936¹ and in holding that the said shares of petitioner's capital stock were of a value to petitioner as of the date of the alleged receipt.

1. See Appendix i.

SPECIFICATION OF ERRORS.

The petitioner relies on the following specification of errors:

(1) The Board of Tax Appeals erred in the determination that there was received from San Francisco Wigwam Theatre Co., a California corporation and a wholly owned subsidiary of Golden State Theatre & Realty Corporation, likewise a California corporation, petitioner herein, 4397 shares of the capital stock of petitioner and that said alleged receipt is taxable to petitioner as a dividend under the provisions of Section 115 (a) and (j) of the Revenue Act of 1936.

(2) The Board erred in the determination that said 4397 shares of petitioner's capital stock were of a value to petitioner, at the date of said alleged receipt, of \$65,295.45.

(3) The Board erred in the determination that said 4397 shares of petitioner's capital stock were not treasury stock of petitioner while in the hands of San Francisco Wigwam Theatre Co., a wholly owned and fully controlled subsidiary.

(4) The Board erred in concluding that provisions of California law under which shares of the stock of a parent corporation held by a wholly owned and controlled subsidiary must be regarded as treasury stock, are irrelevant to the application of the Federal Revenue Act.

(5) The Board erred in determining income tax deficiency for the year 1936 in the sum of \$15,562.51.

(6) The Board erred in not ordering and deciding in favor of petitioner and against respondent.

SUMMARY OF THE EVIDENCE.

The case was submitted on a written stipulation of facts, which facts were found by the Board of Tax Appeals as stipulated and are included as a part of the record on appeal. (Tr. pp. 19-34, incl.) No other or additional evidence was introduced.

Briefly summarized the facts of the case are as follows:

Petitioner has been engaged in the theatre business in the City and County of San Francisco, State of California, for a number of years, approximately fifteen, last past and immediately preceding the year 1936. San Francisco Wigwam Theatre Co. is also a California corporation, having its principal place of business in San Francisco. Both of these corporations were in existence during all of the times referred to in this brief. In the year 1931 and continuously up to and including the present time, petitioner owned all of the issued and outstanding capital stock of San Francisco Wigwam Theatre Co. and as a result San Francisco Wigwam Theatre Co. was a wholly owned subsidiary of petitioner.

During the year 1931 San Francisco Wigwam Theatre Co. acquired by purchase from outside parties 4397 shares of the capital stock of petitioner. Certifi-

icates evidencing those shares were issued to and in the name of San Francisco Wigwam Theatre Co. by Petitioner and so stood of record continuously until December 15, 1936. The persons from whom said shares were purchased and the manner and mode of payment are set forth in the stipulation which is part of the record. (Tr. pp. 21-24, incl.)

On May 12, 1936, the Board of Directors of San Francisco Wigwam Theatre Co. authorized the transfer of said 4397 shares by the subsidiary to the parent, petitioner herein, by a resolution donating the stock purchased by it to petitioner. (Tr. pp. 31-34, incl.) On December 15, 1936, the transfer was made and new certificates evidencing said shares were issued in the name of petitioner.

It was stipulated that the book value of the shares involved was the sum of \$65,295.45 (Tr. p. 24) and respondent held that this amount was taxable to petitioner as a dividend under Section 115 (a) and 115 (j) of the Revenue Act of 1936. Petitioner contended that this was not a taxable dividend because the shares involved were treasury stock of petitioner in the hands of San Francisco Wigwam Theatre Co. and in receiving its own stock petitioner received nothing of value to itself.

SUMMARY OF ARGUMENT.

Petitioner was not taxable on the dividend alleged to have resulted from the transfer of this stock from the subsidiary to the parent by reason of the fact that under the laws of the State of California said stock was treasury stock and the same was of no value to petitioner. Therefore, the transfer resulted in no gain to petitioner even though it might be held to be a dividend. In other words, no property of value was transferred, no gain resulted and to levy a tax where no tax is due would be to violate the purpose and intent of the Internal Revenue Act.

ARGUMENT.**I.****THE TRANSFER INVOLVED WAS NOT A TRANSFER
OF VALUE.**

It is the contention of petitioner that the transfer of the stock involved herein from San Francisco Wigwam Theatre Co. to Golden State Theatre & Realty Corporation, petitioner, was not a transfer of value and therefore was not taxable. At the time of the receipt of the shares by petitioner entries were made upon its books and records treating the stock as treasury stock. The first entry in relation to this stock on April 3, 1937 (Tr. p. 23) treated the stock as an asset even though as a matter of law, as will hereinafter be shown, said stock was not at any time an asset of petitioner. Thereafter and on January 2, 1938, as a

result of an independent examination made by Robert O. Folkoff, C.P.A., the entry of April 3, 1937 was reversed to reflect the true situation in relation to the stock. (Tr. p. 24.) Such independent auditor, realizing that an error had been made in the original entry considering the stock as an asset of petitioner, corrected such entries to show that the surplus was not affected by the acquisition of such stock and that the same was not an asset. A new entry was added as a mere memorandum entry to record the acquisition of the shares and to show that they did not affect the net worth of the corporation. (Tr. p. 24.) The entire transaction set forth above, both from an accounting standpoint and an actual standpoint, was simply a bookkeeping transaction, there being no transfer of property of value.

If we assume for the purpose of argument that petitioner purchased this stock from its surplus from the same persons from whom it was purchased by San Francisco Wigwam Theatre Co., there would be no question of a tax arising in this case. It appears to petitioner that there is no difference in this instance between the acquisition by San Francisco Wigwam Theatre Co. and the supposed acquisition by petitioner in the first instance. This contention is clearly supported by the laws of the State of California and by the other authorities hereinafter cited. Sections 342, 342a and 342b² of the Civil Code of the State of California establish a system or scheme relating to the

2. See Appendix i-v.

acquisition by a corporation of its own stock. These sections must be read together in order to determine their legal effect and the rules as established therein must apply with equal force to the acquisition of its own stock by a parent or by a parent through a subsidiary. To do otherwise would be to disregard the force of the statute and to provide a means of accomplishing indirectly what cannot be accomplished directly. Therefore, in the case before the Court the acquisition of the stock of petitioner by San Francisco Wigwam Theatre Co. was in legal effect the same as if the stock was acquired by petitioner. This because in the hands of San Francisco Wigwam Theatre Co. under the sections hereinabove referred to the stock was subject to the same prohibitions as if it was originally purchased by petitioner. Section 342 of the Civil Code, *supra*, provides in part as follows:

“A corporation may not purchase directly or indirectly any shares issued by it or by any corporation by which it is controlled, except as follows:
* * *

Section 342a of the Civil Code, *supra*, sets forth the effect of the acquisition of such shares and Section 342b of the Civil Code, *supra*, specifically prohibits treasury stock from being used for certain purposes, stating in part as follows:

“* * * Treasury shares shall not carry voting or dividend rights and shall not be counted as outstanding shares for any purpose, nor as assets for the purpose of computing a surplus available for

dividends or the purchase of shares issued by the corporation or the making of any other distributions to its shareholders. * * *

It is therefore petitioner's conclusion that the stock had no value whatsoever either to San Francisco Wigwam Theatre Co. or petitioner unless it was at a later date resold. In determining the nature of treasury stock the case of *Borg v. International Silver Co.* (1925), 11 F. (2d) 147, held as follows:

"Treasury shares are necessarily retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability. Indeed, the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch in the market, while the second has disappeared altogether. * * *

To carry the shares as a liability and as an asset at cost, is certainly a fiction however admirable. They are not a liability and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset because as they stand, the defendant cannot collect on them. What in fact they are is an opportunity to acquire new assets for the corporation's treasury by creating new obligations. * * * In any event, there can be no ambiguity in stating the facts more directly * * *; that is, in treating the shares as not in existence while held in the treasury except as a possible source of asset at some future time, when by sale at once they become liabilities and their proceeds assets."

Contrary to the foregoing position the respondent takes the stand that the receipt by petitioner of the shares of its own stock constituted the receipt of a taxable dividend. It must be admitted even by respondent that petitioner received nothing other than treasury shares. These shares were of no value to it. Therefore, being of no value, they did not constitute a taxable dividend. Section 115 (j) of the Revenue Act of 1936 provides as follows:

“If the whole or any part of a dividend is paid by a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value *at the time as of which it becomes income to the shareholder.*” (Italics supplied.)

Assuming for the purpose of argument, only, that the transfer of this stock from San Francisco Wigwam Theatre Co. to petitioner was a dividend, it is still contended that the transfer was not taxable within the meaning of Section 115 (j), *supra*. In order for a dividend in property other than money to be taxable, such a dividend must be income to the recipient. Income is defined as a *gain* derived from capital, from labor or both combined. (Regulations 94, Art. 22(a)-1.) Thus to determine if the dividend resulted in income to the shareholder we must see if there was a gain. That question is determined by the nature of the property interest which the shareholder has acquired. That in turn is determined by state law, for, as was held in the recent case of *Morgan v. Commissioner* (1940),

309 U. S. 75, 60 S. Ct. 424, "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, *so created*, shall be taxed." (Italics supplied.)

Petitioner is a corporation organized and existing under and by virtue of the laws of the State of California and its entire operations are controlled by state law. Its property rights may be restricted and affected by that law and as a matter of fact its rights are affected and restricted by the operation of the Civil Code sections of the State of California hereinabove referred to. Petitioner contends that where its property rights are so affected by California law the fixing of values cannot be determined independently of California statutes. As a result of these statutes the stock is subject to the same prohibitions and limitations upon its uses and values in California or anywhere else.

The member of the Board of Tax Appeals in considering this point erred in entirely disregarding the effect of state law. In the opinion of the Board it was said "irrespective of whether the petitioner's shares when owned by the Wigwam corporation could be regarded for purposes of California law as treasury stock, this would be irrelevant to the application of the federal statute". (Tr. p. 10.) It is obvious, then, that the Board member disregarded the application of California law in considering the value of this stock either in the hands of San Francisco Wigwam Theatre Co. or in the hands of petitioner on the assumption that the state law is irrelevant to the application of the federal

statute. The case of *Morgan v. Commissioner*, *supra*, would seem to require the state law to be applied in a situation of this type and, in addition, it is contended that there is an analogy between the application of the Federal Revenue Act to the community property cases and to the instant case. In other words, the United States Supreme Court has held that the Internal Revenue Act must be applied in relation to the property laws of the several states, thus recognizing that the nature of that property is affected by state statute. In *Poe v. Scaborn* (1930), 282 U. S. 101, 51 S. Ct. 58, the question was whether it was proper for a husband and wife to file separate income tax returns for the year 1927. It was undisputed that all of the property of the parties consisted of community property but the Commissioner contended that all of the income from this property should have been reported in the husband's return. However, the Commissioner conceded that the answer to the question involved had to be found in the provisions of the law of the state in determining the wife's ownership of or interest in the community property. The Court so held and this case established the principle in relation to the reporting of income from community property, thereby determining that the nature of the interest of the parties in and to community property must be determined by the law of the state in question. This case was followed without question in *Goodell v. Koch* (1930), 282 U. S. 118, 51 S. Ct. 62; *Hopkins v. Bacon* (1930), 282 U. S. 122, 51 S. Ct. 62; *Bender v. Pfaff* (1930), 282 U. S. 127, 51 S. Ct. 64; *United States v. Malcolm* (1931), 282 U. S. 792, 51 S. Ct. 184; see, also, *Lang v.*

Commissioner (1938), 304 U. S. 264, 58 S. Ct. 880; *Cannon v. Nicholas* (1935), 80 F. (2d) 934.

It would appear, then, that there is no difference between a state statute affecting property of individuals and a state statute affecting the property of a corporation. If the Internal Revenue Act must be considered in the light of the interest of husband and wife in property as determined by state statute, why should not the same rule apply in determining property rights in relation to a corporation? The sections of the Civil Code of the State of California, *supra*, definitely affect the use and value of the stock involved in this case and that value cannot be determined for the purpose of taxation under the Federal Revenue Act without considering the effect of the California law. To do otherwise would be to ignore the true nature of the transaction as determined by California law and to place a tax where no tax is due.

Supporting the principles advanced herein is the case of *Tooley, Executor v. Commissioner* (1941), 121 F. (2d) 350, in which this Court stated that the question to be determined was whether a surviving co-tenant's estate vested by transfer from his co-tenant at the latter's death or vested when the joint tenancy was created. This question, the Court said, was to be determined by California law, that state being the state in which the property was located. It concluded that under California law there was no transfer at the death of one joint tenant to the other, stating:

“In California the surviving co-tenant no more has anything transferred to him on the other co-tenant's death than does the grantee of a remain-

der in fee have anything transferred to him by the life tenant at the latter's death. Quite likely, the change by enhancement to the fee owner by the death of the life tenant could be made the 'occasion' for an excise tax, but it would be a distortion of all California and common law concepts of property ownership to call the 'change' a transfer from the life tenant."

It was the contention of the Commissioner in this case that California law should not be determinative on the ground that "taxation is 'eminently practical' and is not to be restricted by refined technicalities of local law". To this the Court answered:

"We see nothing in section 311 which requires us to hold the character of the survivor of a joint tenancy in California held by its courts to be that of the common law to be a 'refined technicality of local law'. To sustain the Commissioner concerning such an estate in California would be a repudiation of *Erie Railway Co. v. Tompkins*, 304 U. S. 64, rather than an 'eminently practical' extension of the federal power of taxation."

The importance of state law in determining questions of the nature of this case before the Court is indicated by the decision of the Supreme Court in the case of *Blair v. Commissioner* (1937), 300 U. S. 5, 57 S. Ct. 330. The taxpayer in that case was the beneficiary of a testamentary trust. He executed certain assignments of the income of that trust to his children, in advance, and the income was actually paid to them. The Commissioner contended that the income was taxable to the petitioner and not to the assignees. The

Court, however, held that the tax was to be imposed on the one who was to receive the income as the owner of the beneficial interest and it must look to the law of the state to determine who is the owner of the beneficial interest. The Court said in part:

“If under the law governing the trust, the beneficial interest is assignable, and if it has been assigned without reservation, the assignee thus becomes the beneficiary and is entitled to rights and remedies accordingly.

* * * * *

“The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law. By that law, the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign that interest in whole or in part are to be determined.”

It is submitted that the problem of the case before the Court affords a close analogy to that presented in *Blair v. Commissioner*, supra. There the tax was to be imposed on the one who received the income and that fact had to be determined by a consideration of state law; here the tax is to be imposed if income was received and whether or not income was received must be determined by a consideration of state law. Here the petitioner is a resident of the State of California and its use and disposition of the property of that state is subject to its law. By that law the character of the property, the nature and extent of the interest of petitioner and the power of petitioner to use that property in any way are to be determined.

II.

THE SUBSTANCE AND NOT FORM SHOULD BE DETERMINATIVE OF THE APPLICATION OF THE TAXING ACT.

The preceding argument has been devoted to the proposition that the stock was valueless to petitioner from the time of its acquisition by San Francisco Wigwam Theatre Co. and has never been of value to petitioner insofar as this case is concerned, there being nothing in the record to indicate that it has been sold. If this Court should hold that this stock is of value, it would be looking to form alone and disregarding the substance and real nature of the entire transaction. It has been the contention of respondent in this case that the transfer of the stock of record from the books of San Francisco Wigwam Theatre Co. to the books of petitioner resulted in a dividend in kind as of the book value of said stock to the subsidiary. It is the position of the petitioner, borne out by the authorities and arguments hereinabove set forth, that the purchase of the stock by the subsidiary was in effect the purchase by the parent. It is clear, then, that because of the peculiar method which was followed in this case the respondent is attempting to collect a tax which is not at all merited by the actual facts. It is submitted that petitioner should not be penalized because it indulged in a form which might be construed to be taxable when in fact no taxable transaction resulted. The federal cases hold that substance and not form determines the application of the taxing act to gains and losses where property is transferred to one corporation controlled by another. This rule was applied in the case of *Labrot v. Burnet* (1932), 57 F. (2d) 413,

and in *Commissioner v. Woods Machinery Co.* (1932), 57 F. (2d) 635, in the latter case in which it is stated:

“Whether acquisition of its own capital stock gives rise to a taxable gain or loss depends upon the real nature of the transaction.”

The transaction here involved merely a bookkeeping transfer of treasury stock from a wholly owned subsidiary to its parent. This transfer did not and could not result in income to the transferee. It would be an anomaly indeed if the law would hold contrary to the fact. It was held in the case of *Robert P. Hyams Co., Inc. v. United States* (1928), 26 F. (2d) 805:

“The trend of authority is to the effect that mere bookkeeping methods neither create nor change any fact; that bookkeeping entries have only an evidentiary value; that the courts, in the absence of positive law to the contrary, will construe a revenue law as intended to reach actual income, the books to be regarded as neither indispensable nor conclusive; and that a decision must rest upon the actual facts.”

In addition, Treasury Regulations 94, Revenue Act of 1936, Art. 115-3, state:

“In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.”

If, then, the laws of the State of California must be applied in determining this case, the application of that law to the case hereinabove cited supports the

contention of petitioner that the respondent is attempting to take advantage of simple bookkeeping transactions to collect a tax, even though those entries and the transfers referred to do not and did not actually result in an increase in the assets of petitioner or a gain within the meaning of the Internal Revenue Act.

It is therefore submitted that the Board erred in its decision in holding that the laws of the State of California did not apply and in ignoring the fact that income did not result from this transaction by reason of the fact that the stock was of no value to petitioner, as hereinabove set forth. It is further submitted that it is not the purpose or intent of the income tax law to permit, nor should this Court permit, a tax to be collected in any case where no tax is due.

Dated, San Francisco,

October 22, 1941.

Respectfully submitted,

L. S. HAMM,

B. E. KRAGEN,

LIONEL B. BENAS,

Attorneys for Petitioner.

JESSE FELDMAN,

Of Counsel.

(Appendix Follows.)

Appendix.

Appendix

Revenue Act of 1936:

Sec. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) Definition of dividend.—The term “dividend” when used in this title (except in Section 203 (a) (3) and Section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(j) Valuation of dividend.—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Civil Code of the State of California:

Sec. 342. Acquisition by a corporation of its own shares and shares of a holding corporation: (When permissible: Available funds: Reduction of surplus). A corporation may not purchase directly or indirectly any shares issued by it or by any corporation by which it is controlled, except as follows:

(1) To collect or compromise in good faith a debt, claim or controversy with any shareholder;

(2) From shareholders who by reason of dissent from any proposed corporate action are entitled under section 369 of this title to be paid the fair market value of their shares;

(3) From one who as an employee other than as an officer or director has purchased such shares from the corporation under an agreement reserving to the corporation the option to repurchase or obligating it to repurchase such shares;

(4) To eliminate fractional shares;

(5) To redeem or purchase shares subject to redemption at prices not exceeding the redemption price thereof;

(6) To carry out provisions of its articles authorizing conversion of its shares;

(7) Pursuant to section 348b of this title; or

(8) Subject to any limitations contained in its articles, out of earned surplus.

Shares may be acquired either out of stated capital or from any surplus under subdivisions (1) to (5) inclusive of this section. Purchasers from earned surplus under subdivision (8) of this section are not limited to cases authorized under other subdivisions of this section.

(Reduction of surplus.) Upon any purchase of such shares out of earned or paid-in surplus when authorized under this section, the earned or paid-in surplus

shall be reduced by an amount equal to the purchase price of such shares, but the stated capital shall not be affected thereby.

A corporation may acquire its own shares or shares of any other corporation, domestic or foreign, by gift or bequest or upon a merger or consolidation with or by distribution of the assets of another corporation, domestic or foreign.

A corporation shall not purchase or redeem shares of any class under this section in any case when there is reasonable ground for believing that the corporation is unable, or by such purchase or redemption, will be rendered unable, to satisfy its debts and liabilities when they fall due, except such debts and liabilities as have been otherwise adequately provided for. No redemption of shares shall be made if there be reasonable ground for believing that the net assets would be reduced thereby to an amount less than the lowest aggregate liquidation preferences of shares to remain outstanding having prior or equal claims to the assets.

The payment of a debt or liability shall be deemed to have been adequately provided for if the payment thereof shall have been assumed or guaranteed in good faith by a financially responsible person or persons.

(Construction of section.) Nothing in this section shall be construed to prohibit shares being forfeited to a corporation for delinquent assessments or nonpayment of the subscription price thereon.

A corporation shall be deemed to be controlled by another corporation when such other corporation is a

holding corporation thereof as defined in this title. (Added by Stats. 1931, p. 1800; Am. Stats. 1933, p. 1381.)

Sec. 342a. Effect of acquisition of own shares. When a corporation acquires its shares out of earned surplus, pursuant to subdivisions (1) to (8), inclusive, of section 342, Civil Code, or out of paid-in surplus under subdivisions (1) to (5), inclusive, of section 342, Civil Code, or by gift or bequest, or upon the distribution of the assets of another corporation, or upon forfeiture, such shares may be carried as treasury shares or may (at the option of the board of directors) be retired, but no change in the stated capital shall be made either upon the acquisition or retirement of such shares unless proceedings are duly taken to that end under section 348, Civil Code, except that when a corporation acquires its shares by purchase or forfeiture upon which part of the agreed subscription price remains unpaid, the stated capital shall be reduced by the amount unpaid upon such shares without further proceedings.

Out of stated capital. When a corporation acquires its shares out of stated capital, under subdivisions (1) to (5), inclusive, of section 342, Civil Code, such shares shall be restored to the status of authorized but unissued shares and the stated capital may be reduced by resolution of the board of directors by the amount of stated capital attributable to such shares. The amount of stated capital attributable to a share shall be determined by dividing the stated capital attributed to the class or series of shares to which such shares

belong by the number of shares of such class or series outstanding immediately prior to the acquisition of such shares.

Out of surplus. When a corporation acquires its shares out of surplus arising from reduction of stated capital, such surplus shall be reduced by the amount of the purchase price thereof and such shares shall be restored to the status of authorized but unissued shares without reduction of stated capital.

If the articles prohibit the reissue of any shares acquired, then upon their acquisition the authorized number of shares of the class to which such shares belonged shall be reduced by the number of shares so acquired.

Shares of the corporation surrendered to it on the conversion or exchange thereof into or for other shares of the corporation pursuant to authority or provision of the articles, shall, after such conversion or exchange, have the status of authorized but unissued shares, and the stated capital shall remain unchanged thereby and by the issue of the new shares in place of those so retired. (Added by Stats. 1931, p. 1800; Am. Stats. 1933, p. 1382.)

Sec. 342b. Treasury shares: (Status: Retirement: Disposition of consideration received: Reduction of stated capital). Treasury shares shall not carry voting or dividend rights and shall not be counted as outstanding shares for any purpose, nor as assets for the purpose of computing a surplus available for dividends or the purchase of shares issued by the corpo-

ration or the making of any other distributions to its shareholders. Unless otherwise provided in the articles, such shares may be retired and restored to the status of authorized and unissued shares without reduction of stated capital or may be disposed of for such consideration as the board of directors may fix, and the consideration received shall be added to paid-in surplus except as far as needed to write off a deficit of net assets below the amount of stated capital.

Redeemable shares. Redeemable shares which have been acquired from earned surplus and carried as treasury shares may be retired by resolution of the board of directors and stated capital may be reduced thereon as if acquired out of stated capital without proceedings under section 348, Civil Code. (Added by Stats. 1931, p. 1801; Am. Stats. 1933, p. 1383.)

No. 9902

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

GOLDEN STATE THEATRE & REALTY CORPORATION, A
CALIFORNIA CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

J. LOUIS MONARCH,
HUBERT L. WILL,
Special Assistants to the Attorney General.

FILED

NOV 28 1941

**PAUL P. O'BRIEN,
CLERK**

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	2
Summary of argument.....	5
Argument:	
I. The distribution by a subsidiary to a parent of the latter's own shares results in income to the parent.....	5
II. The parent-subsidiary relationship does not alter the char- acter of the transaction.....	9
Conclusion.....	12
Appendix.....	13-15

CITATIONS

Cases:

<i>Allyne-Zerk Co. v. Commissioner</i> , 83 F. (2d) 525.....	6
<i>Burnet v. Clark</i> , 287 U. S. 410.....	11
<i>Burnet v. Commonwealth Imp. Co.</i> , 287 U. S. 415.....	11
<i>Commissioner v. Boca Ceiga Development Co.</i> , 66 F. (2d).....	6
<i>Commissioner v. S. A. Woods Mach. Co.</i> , 57 F. (2d) 635.....	6
<i>Dorsey Co. v. Commissioner</i> , 76 F. (2d) 339.....	6
<i>Haden Co. v. Commissioner</i> , 118 F. (2d) 285.....	11
<i>Helvering v. American Hide Co.</i> , 291 U. S. 426.....	11
<i>Helvering v. Jane Holding Corp.</i> , 109 F. (2d) 933.....	11
<i>Helvering v. Reynolds Co.</i> , 306 U. S. 110.....	8
<i>Higgins v. Smith</i> , 308 U. S. 473.....	11
<i>Horn & Hardart Baking Co. v. United States</i> , 34 F. Supp. 89.....	6
<i>Squibb, E. R., & Sons v. Helvering</i> , 98 F. (2d) 69.....	6
<i>United States v. Kirby Lumber Co.</i> , 284 U. S. 1.....	11

Statutes:

California Civil Code, Sec. 342.....	10
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 13.....	13
Sec. 26.....	13
Sec. 115.....	13

Miscellaneous:

Hills, Stated Capital and Treasury Shares, 57 Jour. of Account- ancy 202 ff.....	6
Marple, Capital Surplus and Corporate Net Worth, c. 5, p. 53..	6
Marple, Treasury Stock, 57 Jour. of Accountancy 257 ff.....	6
Treasury Regulations 77, Art. 66.....	14
Treasury Regulations 94, Art. 115-10.....	14

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OPINION BELOW

The memorandum opinion of the Board of Tax Appeals (R. 9-10) is not reported.

JURISDICTION

The petition for review involves income taxes for the year 1936 in the amount of \$15,562.51 and is taken from the decision of the Board of Tax Appeals entered March 28, 1941. (R. 11.) A motion for reconsideration, review by the entire Board, and in the alternative for a rehearing was filed April 28, 1941. Review by the entire Board was denied by an order entered April 29, 1941, and reconsideration and rehearing was denied by an order entered May 3, 1941.

(R. 11-12.) The case is brought to this Court by petition for review filed July 16, 1941 (R. 12-17), pursuant to the provisions of Section 1141-1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the transfer to taxpayer from its wholly-owned subsidiary of 4,397 shares of taxpayer's stock owned by the subsidiary was a dividend under Section 115 of the Revenue Act of 1936.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 13-15.

STATEMENT

The facts as stipulated by the parties (R. 19-34) may be summarized as follows:

The taxpayer is a California corporation having its principal place of business in the City of San Francisco. From January 2, 1930, up to and including the date of hearing of this case before the Board, the taxpayer owned all of the issued and outstanding stock of San Francisco Wigwam Theatre Company, also a California corporation with its principal place of business in San Francisco. (R. 20-21, 29.) On July 8, 1931, the subsidiary purchased 2,500 shares of the taxpayer's capital stock from Victoria Mariani for \$25,000, and on October 2, 1931, purchased 2,530 shares of the taxpayer's stock from Cecil B. DeMille Productions, Inc., for \$30,935. On the latter date it sold 633 shares of such stock to David Bolton for \$7,733.75. (R. 21-22.) On September 30, 1931, R. A. McNeil, a

vice president of the taxpayer, was paid a commission of \$2,500 by the subsidiary in connection with the purchase of the 2,500 shares from Victoria Mariani, which amount McNeil on January 18, 1937, paid to the taxpayer. The \$2,500 paid by McNeil to the taxpayer was credited to the latter's earned surplus account. (R. 22.) The cost of the 4,397 shares of taxpayer's stock to the subsidiary was \$50,701.25, including McNeil's commission. (R. 22.)

On October 8, 1931, the certificates representing the 4,397 shares purchased from Victoria Mariani and Cecil B. DeMille Productions, Inc. were canceled and new certificates issued in the name of San Francisco Wigwam Theatre Company, the subsidiary. On December 15, 1936, the certificates standing in the name of the subsidiary were canceled and new certificates issued in the name of Golden State Theatre & Realty Corporation, the parent. (R. 22-23.)

The 4,397 shares in question were carried until December 31, 1936, by the subsidiary as an asset in its stocks and bonds account. On that date a charge of \$50,701.25 was made to the earned surplus account of the subsidiary and a corresponding credit made in the stocks and bonds account. (R. 23.) The parent, on April 3, 1937, made entries in its books by which it set up the treasury stock as an asset in the amount of \$43,970 and transferred an equivalent amount to capital surplus. On January 2, 1938, the entries made in the preceding year were reversed to the extent that instead of crediting capital surplus, a special item designated "Donated Surplus Treasury Stock" was set up. (R. 23-24.)

The minutes of the meeting of the board of directors of San Francisco Wigwam Theatre Company, the subsidiary, at which the transfer of the shares in question to the parent was authorized, state in part (R. 33):

The president then stated that this corporation is the owner of 4397 shares of the capital stock of Golden State Theatre & Realty Corporation, which last named corporation owns all of the issued and outstanding stock of this corporation, with the exception of the qualifying shares held by the directors. He stated that in his opinion it is advisable for this corporation to donate said 4397 shares of stock of said Golden State company to the latter corporation and he asked the consideration of the directors with respect to the proposal. Upon motion of Director M. Naify, seconded by Director McNeil, the following resolution was then passed without dissenting voice:

Resolved, that this corporation convey to Golden State Theatre & Realty Corporation 4397 shares of the stock of the last named corporation now owned by this corporation and that if in the judgment of this corporation's accountant said transaction should be so handled, said conveyance be by way of a donation made by this corporation to said Golden State Theatre & Realty Corporation.

In its income tax return for the year 1936, taxpayer did not include as dividends received any value for the 4,397 shares in question. By letter dated December 5, 1939, the Commissioner of Internal Revenue asserted a deficiency in taxpayer's income tax for the year 1936 of \$15,562.51 resulting from the inclusion in net income of \$11,240 received as cash dividends,

and \$65,295.45, the asserted fair market value of the 4,397 shares of stock received from the subsidiary. (R. 25-29.)

The Board of Tax Appeals held that the transfer of the shares was a dividend under Section 115 of the Revenue Act of 1936 and that the Commissioner's determination was therefore correct. (R. 9-10.)

SUMMARY OF ARGUMENT

The taxpayer received 4,397 of its own shares in the nature of a dividend from its wholly-owned subsidiary. This was income to petitioner in the amount of the fair market value of the stock for to that extent the claims against the corporation were reduced and the interest of the remaining shareholders was increased.

The situation is just as though the subsidiary had declared a cash dividend equivalent to the fair market value of the stock and the taxpayer had then purchased the shares itself. Such a cash dividend would be income to petitioner. A dividend in its own stock or any other property is no less income.

The parent-subsidiary relationship does not alter the character of the transaction.

ARGUMENT

I

The distribution by a subsidiary to a parent of the latter's own shares results in income to the parent

During the year 1936, the taxpayer received from its wholly-owned subsidiary 4,397 shares of its own stock which the subsidiary had acquired from the

public. The taxpayer paid no consideration for the shares. It is the Commissioner's position that as a result of this acquisition the taxpayer received income in the nature of a dividend equivalent to the fair market value of the shares on the date of the transfer. The taxpayer concedes the accuracy of the valuation of the stock; the sole question raised is as to whether it realized income from the acquisition of its own shares.

The decisions are numerous and uniform that a corporation may realize income from the acquisition of its own shares notwithstanding the fact that good accounting practice probably requires that such shares when acquired by the issuer be not treated as assets but rather as affecting a reduction in capital.¹ *Commissioner v. S. A. Woods Mach. Co.*, 57 F. (2d) 635 (C. C. A. 1st); *Commissioner v. Boca Ceiga Development Co.*, 66 F. (2d) 1004 (C. C. A. 3d); *Dorsey Co. v. Commissioner*, 76 F. (2d) 339 (C. C. A. 5th); *Allyne-Zerk Co. v. Commissioner*, 83 F. (2d) 525 (C. C. A. 6th); *Horn & Hardart Baking Co. v. United States*, 34 F. Supp. 89 (E. D. Pa.). See also *E. R. Squibb & Sons v. Helvering*, 98 F. (2d) 69 (C. C. A. 2d).

¹ Discussions as to the correct manner of handling treasury stock are numerous and while most accountants are in agreement that treasury stock should not be treated as an asset, they recognize that as a practical matter it is frequently carried as such. See, for example, Hills, Stated Capital and Treasury Shares, 57 Jour. of Accountancy 202 ff.; Marple, Capital Surplus and Corporate Net Worth, c. 5, p. 53; Marple, Treasury Stock, 57 Jour. of Accountancy 257 ff.

Each of these cases involved the acquisition by a corporation of its own shares either in exchange for assets having less value than the shares or as in the *Woods* case, *supra*, in satisfaction of a claim, the cash payment of which would have been income. In each case the court held that all or such part of the shares as exceeded the cost to the corporation of the assets given in exchange for them was income, for to that extent the remaining shareholders were enriched. In the language of the opinion in the *Squibb* case, *supra* (p. 71):

In both situations the remaining shareholders are enriched by the full present value of the shares; and this is a part income, *or all income*, according as the consideration given in exchange had or had not any "basis". [Italics supplied.]

The application of the principles enunciated in the foregoing cases to the present situation is apparent. Here, the taxpayer received its own shares without giving any consideration therefor. Clearly, if the subsidiary had declared a cash dividend equivalent to the fair market value of the taxpayer's shares in question, the receipt thereof would have been income. But the benefit to the taxpayer here was the same, for to the extent that the number of shares outstanding was reduced the interest of the remaining stockholders was enhanced just as the receipt of any other income would have increased the value of their shares.

The present situation, that of a corporation realizing income on the *acquisition* of its own shares, should not be confused with its converse, the *sale* by a corporation

of its own shares at more than par or the sale of treasury shares for more than was paid for them. The rule in such cases appears to be that the excess is merely additional capital. *Helvering v. Reynolds Co.*, 306 U. S. 110; *E. R. Squibb & Sons v. Helvering*, *supra*. In this connection it should be noted that the Treasury Regulations since 1933 recognized that even in this situation a corporation dealing in its own shares on a commercial basis, as it might in the shares of another corporation, i. e., buying and selling regularly, may realize taxable income or suffer a deductible loss. Treasury Regulations 77, Article 66, Appendix, *infra*.

Where, however, the corporation acquires its own shares for less than their value, the many decisions are uniform that it realizes income to the extent of the difference between the consideration paid and the value of the shares. Since in the instant case, the taxpayer paid nothing for the 4,397 shares acquired from the subsidiary, the entire value of such shares was, as the Commissioner and the Board have found, income to it.

As a practical matter the situation is just as though the subsidiary had declared a cash dividend equivalent to the value of the shares and the taxpayer had used the cash to purchase them. Had that been done there can be no question but that the taxpayer would have received taxable income in the amount of the cash dividend. It received no less here.

In connection with this analogy, the opinion in the *Woods* case, *supra*, is particularly appropriate. The corporation there had acquired its own shares in satisfaction of a debt owed it by the stockholder, the pay-

ment of which in cash would have been income. The court said (p. 636):

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of stock were bypassed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. The wide door to evasion of taxes opened by the decision of the Board is an additional reason, and a weighty one, against it.

The possibility of evasion is, of course, equally present here, for the subsidiary had the alternative of declaring a cash dividend which the taxpayer might have used to purchase the shares or of acquiring the stock and subsequently transferring it rather than the cash. It did the latter. There is no difference in result; the taxpayer received income equal to the fair market value of its stock on the date of the transfer.

II

The parent-subsidiary relationship does not alter the character of the transaction

The taxpayer has predicated its entire argument on an assumption that the acquisition of the shares by the subsidiary and the subsequent transfer of them to petitioner is no different in substance than had peti-

tioner itself purchased the shares. On this assumption it has urged that the stock in the hands of the subsidiary was treasury stock and valueless. The fallacy of this argument is obvious. The subsidiary was a separate corporate entity. It had its own creditors. There can be no doubt that the taxpayer's stock in the subsidiary's hands was an asset to which the latter's creditors would have been entitled to look for satisfaction of their claims. Petitioner's shares had as much value in the subsidiary's possession as in the hands of any other stockholder.

Considerable space is also devoted in the taxpayer's brief to the contention that since, under the applicable California statutes, treasury shares may not be considered as assets, no income can result to a corporation from the acquisition of its own stock. The decisions heretofore referred to are a complete answer to this contention for they recognize that while better accounting practice is not to treat treasury shares as assets, notwithstanding this fact a corporation realizes income when it acquires its own shares for less than their value.

Moreover, Section 342 (b) of the California Civil Code merely provides that treasury stock "shall not be counted as * * * assets for the purpose of computing a surplus available for dividends or the purchase of shares issued by the corporation, or the making of any other distribution to its shareholders." Thus the limitation is a narrow one. It does not preclude the resale of the treasury stock and does not affect its market value. Accordingly, the stock is an asset for tax purposes.

This is not the only situation in which income may be realized although the thing received is not strictly speaking an asset in the hands of the recipient. The so-called "cancellation of indebtedness" cases are a pertinent example, for it is well settled that when a solvent individual or corporation obtains a forgiveness or cancellation of indebtedness, the entire amount in the case of forgiveness, or the difference between the indebtedness and the amount paid to obtain the cancellation, is income to the debtor notwithstanding the fact that the notes or other evidence of indebtedness are not an asset in the debtor's hands. *United States v. Kirby Lumber Co.*, 284 U. S. 1; *Helvering v. Amer. Chicle Co.*, 291 U. S. 426; *Helvering v. Jane Holding Corp.*, 109 F. (2d) 933, 940 (C. C. A. 8th); *Haden Co. v. Commissioner*, 118 F. (2d) 285, 286 (C. C. A. 5th).

Finally, the taxpayer has urged that the substance and not the form of the transaction should control. This argument also assumes that the separate corporate entities may be ignored. There is, however, no justification here for treating the taxpayer and its subsidiary as a single corporate entity. They were not in fact, and so far as the record indicates, they operated entirely separately. Cf. *Burnet v. Clark*, 287 U. S. 410; *Burnet v. Commonwealth Imp. Co.*, 287 U. S. 415. In any event, a taxpayer may not, in an effort to avoid taxes, ignore corporate entities of its own creation. See *Higgins v. Smith*, 308 U. S. 473, 477.

The form and the substance here are the same. The taxpayer's subsidiary transferred to its parent in the

nature of a dividend certain of the latter's shares. Petitioner received taxable income therefrom just as it would have had the dividend been payable in cash or other property.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

J. LOUIS MONARCH,

HUBERT L. WILL,

Special Assistants to the Attorney General.

NOVEMBER, 1941.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 13. NORMAL TAX ON CORPORATIONS.

(a) DEFINITION.—As used in this title the term “normal-tax net income” means the net income minus the sum of—

* * * * *

(2) DIVIDENDS RECEIVED.—The credit provided in section 26 (b). Such credit shall not be allowed in the case of a mutual investment company, as defined in section 48.

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(b) DIVIDENDS RECEIVED.—85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this title. The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) DEFINITION OF DIVIDEND.—The term “dividend” when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating

to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * * *

(j) VALUATION OF DIVIDEND.—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 115-10. *Dividends paid in property.*—If the whole or any part of the dividend is paid to a shareholder in any medium other than money, the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder. (See article 42-3.) Scrip dividends are subject to tax in the year in which the warrants are issued.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 66 [as amended by T. D. 4430, XIII-1 Cum. Bull. 36]. *Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss

depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

16
No. 9902

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GOLDEN STATE THEATRE & REALTY COR-
PORATION (a California corporation),

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

L. S. HAMM,

B. E. KRAGEN,

Loew Building, San Francisco,

LIONEL B. BENAS,

Latham Square Building, Oakland,

Attorneys for Petitioner.

FILED

JAN 17 1942

PAUL P. O'BRIEN,

CLERK

Table of Authorities Cited

Cases	Pages
Blair v. Commissioner (1937), 300 U. S. 5, 57 S. Ct. 330...	1
Borg v. International Silver Co. (1925), 11 F. (2d) 147....	1, 3

Codes and Statutes

California Civil Code, Section 342b.....	3
Revenue Act of 1928, Section 23 (p) (1).....	4

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VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF.

After a careful examination of respondent's brief filed herein, it is apparent that no attempt has been made to answer the two main points raised by petitioner in this case, viz., first, that treasury stock is of no value, as held by the case of *Borg v. International Silver Co.* (1925), 11 F. (2d) 147 (Pet.'s Opening Brief, p. 9), and, second, that the laws of the State of California are applicable in the determination of whether or not the stock transaction from which this case arose resulted in a taxable gain to petitioner. (See *Blair v. Commissioner* (1937), 300 U. S. 5, 57 S. Ct. 330, Pet.'s Opening Brief, pp. 12, 13 and 14.)

The cases as cited by respondent, commencing with page 6 of his brief, are all distinguishable and, peti-

tioner believes, not pertinent to the two main points involved. Particular attention is called to the fact that considerable reliance is evidently put upon the case of *Commissioner v. S. A. Woods Machinery Co.* (Resp.'s Brief, p. 6), the facts of which involved a situation where the taxpayer accepted shares of its own stock in satisfaction of a judgment obtained against another corporation. It is obvious, of course, that the facts of that case are in no way comparable with the facts of the case before the Court. In the first place, the S. A. Woods Machinery Co. acquired something it did not have before, to-wit, a judgment obtained in the course of its business and satisfied by the acceptance of its own stock. In the second place, consideration of a statute similar to that of the State of California in this case, was not before the Court. It is to be noted that on page 636 of the opinion the Court stated that the debtor corporation might have paid the taxpayer in cash. It then said:

“If that had been done, clearly the cash received would have been taxable income. The transaction was not changed in its *essential character* by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of stock were by-passed and the stock was directly transferred in payment of the debt. The stock was the medium in which the *debt* was paid.”

Again later, the Court stated:

“Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to a capital gain or deductible loss *depends upon the real nature of the transaction involved* (citing cases) * * * but where the transaction is not of

that character and a corporation has legally dealt in its own stock as it might in the shares of another corporation and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the total income."

It is obvious from the citation just given that the Court considered this case upon its own peculiar facts and the opinion, therefore, is not necessarily of controlling value in the present case.

It is very clear in the instant case that petitioner was not dealing with its own stock as it would the stock of another corporation nor did it acquire anything that could have been of any value to it under California law.

In none of the other cases cited by respondent did the Court consider any statute similar to that of California.

Respondent insists upon emphasizing that there is no difference between the delivery to petitioner of cash or stock. Under the statutes of the State of California, which are here submitted to the Court to be construed for the first time in this regard, there is a very obvious and important distinction. Money paid to petitioner could have been used by petitioner; goods delivered to petitioner could have been used by petitioner. But its own stock could not be utilized by it for any purpose whatsoever nor could it even be considered as an asset upon its receipt. It has and had no value. (Civil Code of the State of California, Sec. 342b; Pet.'s Opening Brief, pp. 8 and 9; *Borg v. International Silver Co.*,

supra.) Even respondent admits that it is better accounting practice not to treat treasury stock as an asset. (Resp.'s Brief, p. 6.) If it were re-sold, the capital asset represented by the proceeds from the sale immediately becomes offset by a corresponding capital stock liability, and there is no net gain or loss to the corporation.

The respondent, on page 9 of his brief, suggests the possibility of evasion by the taxpayer. While it is felt that the point is of no value at all in determining the issues involved, it may be important to note that no such question should have been raised in this case for the reason that the stock involved was purchased by San Francisco Wigwam Theatre Co., a subsidiary, in 1931 (Tr. pp. 31 to 34 incl.), at which time intercorporate dividends were not taxable. (Revenue Act of 1928, Sec. 23 (p.) (1).) Actually, therefore, if the transfer of the stock from the subsidiary to the parent could be construed, in law or in fact, as a dividend payment, such payment was made in 1931 and not in 1936, and no question of evasion could possibly arise with respect to the transaction. As a matter of fact, the only transaction which really involved property of value was the transaction which occurred in 1931, when the San Francisco Wigwam Theatre Co. purchased the stock involved from outside parties. (Pet.'s Opening Brief, p. 4.) The things done in 1936 were simply bookkeeping entries and did not amount, in any sense of the word, to transfers of property for value or, strictly speaking, were they transactions in relation to the stock at all.

As stated in many of the authorities cited by petitioner and respondent, each case should be determined upon its own facts, and upon its own facts it is contended that this is a situation where no gain resulted and no tax is due.

It is therefore respectfully submitted that the Board of Tax Appeals erred in its decision and that the decision of said Board be reversed.

Dated, San Francisco,
January 16, 1942.

L. S. HAMM,
B. E. KRAGEN,
LIONEL B. BENAS,
Attorneys for Petitioner.

United States 17
Circuit Court of Appeals
For the Ninth Circuit.

RAYMOND H. JEHL,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the Northern District of California,
Southern Division.

FILED

DEC - 8 1941

PAUL P. O'BRIEN,
CLERK

United States
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RAYMOND H. JEHL,

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UNITED STATES OF AMERICA,

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Appeal:	
Assignment of Errors.....	111
Designation of Contents of Record on.....	116
Notice of	109
Statement of Points on.....	115
Assignment of Errors.....	111
Attorneys, Names and Addresses of.....	1
Bill of Exceptions.....	12
Judgment and sentence.....	105
Motions of defendant for directed verdict.....	48, 90
Orders denying	48, 90
Motion of defendant Jehl for new trial.....	105
Order denying	105
Motion of defendant Jehl in arrest of judgment	105
Order denying	105
Order settling, allowing and authenticating	
Bill of Exceptions.....	108
Stipulation re Bill of Exceptions.....	107
Stipulation re exhibits.....	106

Index	Page
Witnesses for defendants:	
Amizich, Angelo Gordon	
—direct	72
—cross	74
—redirect	75
Bock, Ferdinand C.	
—direct	48
—cross	50
—redirect	51
—recross	51
Glorr, Eugene E.	
—direct	70
—cross	70
Hines, Clyde H.	
—direct	71
—cross	71
—redirect	72
—recross	72
Jehl, Raymond Howard	
—direct	75
—cross	83
—recalled, direct	101
—cross	102
Woodworth, Leslie A.	
—direct	52
—cross	60
—redirect	65
—recross	67

Index	Page
—by the Court.....	67
—recalled, direct	100
—cross	101

Witnesses for the United States:

Beck, Edwin L.

—direct	31
—cross	32

Becker, John

—direct	99
---------------	----

Byrd, Sam G.

—direct	13
—cross	15

Carrillo, Della

—direct	43
—cross	44
—redirect	47
—by the Court.....	47

Carrillo, Joe

—direct	38
—cross	39

Gaines, Clay

—direct	15
—cross	19
—redirect	21
—recalled, direct	96

	Index	Page
Goon, Earl		
—direct	33
—cross	35
—redirect	37
—recross	38
Hall, Charles B.		
—direct	22
—cross	23
—redirect	24
—recross	25
Harkins, Edward C.		
—direct	26
—cross	29
—redirect	30
—recross	30
—redirect	30
Hirsh, Alex. B.		
—direct	103
—cross	103
Healey, Charles J.		
—direct	93
—redirect	95
—recross	95
—direct	96
Hirsh, Louis		
—direct	96
—cross	97
—redirect	99

Index	Page
—recross	99
—redirect	99
—recross	99
Levin, David	
—direct	91
—cross	92
Thomas, Frank	
—direct	25
Certificate of Clerk.....	113
Designation of Contents of Record on Appeal	116
Indictment	1
Judgment	8
Names and Addresses of Attorneys.....	1
Notice of Appeal.....	109
Statement of Points on Appeal.....	115
Verdict	7

NAMES AND ADDRESSES OF ATTORNEYS

JAMES B. O'CONNOR, Esq.,

Balfour Bldg.,

San Francisco, Calif.

Attorney for Defendant and Appellant.

FRANK J. HENNESSY, Esq.,

U. S. Attorney,

Northern District of California,

VALENTIN C. HAMMACK, Esq.,

Assistant U. S. Attorney,

Northern District of California.

Attorneys for Plaintiff and Appellee.

(INDICTMENT)

No. 27235-S

In the Southern Division of the United States

District Court for the Northern District

of California

First Count: (R. S. 3258) 26 USCA 2810(a);

In the March 1941 term of said Division of said District Court, the Grand Jurors thereof, upon their oaths present:

That

RAYMOND H. JEHL,

TONY RODRIGUES, and

LESTER A. WOODWORTH,

(hereinafter called "said defendants"), on the 28th day of August, 1940, at a place known as the E. A.

Hall Ranch, Route 1, Box 77A, Watsonville, Santa Cruz County, State of California, within said Division and District, knowingly had in their possession and custody and under their control for the distillation of alcohol, a still and distilling apparatus set up without having registered the same in the manner prescribed by Section 2810 (a) of the Internal Revenue Code.

Second Count: (R. S. 3259) 26 USCA 2812:

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment said defendants were engaged in the business of a distiller of alcohol, and then and there wilfully failed to give the notice prescribed by Section 2812 of The Internal Revenue Code.

Third Count: (R. S. 3260) 26 USCA 2814 (a) (1);

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment said defendants having then and there commenced the business of distillers of alcohol, wilfully failed to give the bond prescribed by Section 2814 (a) (1) of the Internal Revenue Code. [1*]

Fourth Count: (R. S. 3281) 26 USCA 2833 (a);

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment said defendants wilfully engaged in and carried on the

*Page numbering appearing at foot of page of original certified Transcript of Record.

business of a distiller of alcohol, with intent to defraud the United States of the tax on the spirits distilled by them.

Fifth Count: (R. S. 3282) 26 USCA 2834;

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment, in a building and on premises at said place, said defendants knowingly made and fermented mash, wort and wash, fit for distillation and for the production of alcohol, other than in a distillery duly authorized according to law.

Sixth Count: (R. S. 3282) 26 USCA 2834;

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment, said defendants, not then nor there being authorized distillers, knowingly separated by distillation the alcoholic spirits from fermented mash, wort and wash.

Seventh Count: 26 USCA 3321;

And the said Grand Jurors upon their oaths do further present: That at the time and place described in the first count of this indictment said defendants did then and there unlawfully, wilfully and knowingly deposit and conceal certain goods and commodities, to-wit, approximately 10 gallons of alcohol, and 100 gallons of whiskey, upon which said goods and commodities there were then and there imposed certain taxes under the Internal Revenue

laws of the United [2] States; that said taxes imposed as aforesaid were then and there due and unpaid to the United States, and the said goods and commodities were deposited and concealed as aforesaid by said defendants with intent then and there to defraud the United States of said taxes;

Eighth Count: 26 USCA 3320;

And the said Grand Jurors upon their oaths do further present: That at the time and place described in the first count of this indictment said defendants then and there knowingly and wilfully did have in their possession with intent to sell the same in fraud of the Internal Revenue laws of the United States the said goods and commodities described in the Seventh Count of this Indictment upon which there were then and there due, imposed and unpaid certain taxes to the United States of America.

Ninth Count: 18 USCA Section 88

And the said Grand Jurors upon their oaths aforesaid do further present: That said defendants, at a time and place to said Grand Jurors unknown, did knowingly, wilfully, unlawfully, corruptly and feloniously conspire, combine, confederate, arrange and agree together, and with divers other persons whose names are to the Grand Jurors unknown, to commit offenses against the United States of America, and the laws thereof, the offenses being to knowingly, wilfully, unlawfully, and feloniously violate the Internal Revenue laws of the United States

(1) By possessing and controlling for the dis-

tillation of alcohol a still and distilling apparatus set up, without having registered the same in the manner prescribed by law;

(2) by engaging in the business of distillers of alcohol without having given the notice prescribed by law; [3]

(3) by having commenced the business of distillers of alcohol, having wilfully failed to give the bond prescribed by law;

(4) by engaging in and carrying on the business of distillers of alcohol with intent to defraud the United States of the taxes on the spirits distilled by them;

(5) by knowingly making and fermenting mash, wort and wash fit for distillation and for the production of alcohol in a building and on premises other than in a distillery duly authorized according to law;

(6) by separating by distillation, alcoholic spirits from fermented mash, wort and wash without being registered distillers;

(7) by removing, concealing and depositing tax unpaid distilled spirits with intent to defraud the United States of the tax imposed thereon;

(8) by possessing, buying, selling, transferring and transporting distilled spirits in immediate containers not having thereto affixed the stamps prescribed by law denoting the quantity of spirits therein and evidencing payment of all Internal Revenue taxes imposed thereon;

(9) by removing to and depositing in premises

other than an Internal Revenue Bonded Warehouse tax unpaid distilled spirits;

(10) by having in their possession and custody tax unpaid distilled spirits for the purpose of selling the same in fraud of the Internal Revenue laws and with design to avoid payment of the tax imposed thereon;

(11) and by carrying on the business of wholesale liquor dealers without having paid the special tax therefor as required by law. [4]

And the said Grand Jurors, upon their oaths aforesaid, do further charge and present that in pursuance of, and in furtherance of, in execution of, and for the purpose of carrying out and to effect the object, design and purposes of said conspiracy, combination, confederation and agreement aforesaid, the hereinafter named defendants did at the times hereinafter set forth, commit the following overt acts within the Southern Division of the Northern District of California, and within the jurisdiction of this Court:

1. On or about March 9, 1940, in the City of Watsonville, County of Santa Cruz, State of California, said defendants Tony Rodrigues and John A. Woodworth signed a lease for the premises known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

2. On or about April 2, 1940 in the City of Watsonville, County of Santa Cruz, California, said defendant Lester A. Woodworth signed an application for electric service for the premises known as the

Hall Ranch, Route 1, Box 77A, Watsonville, California.

3. On or about June 15, 1940 said defendant Raymond Jehl bought ten 100-lb. sacks of sugar from the Independent Grocery Company, located at 169 Main Street in the City of Watsonville, County of Santa Cruz, California.

4. On or about August 28, 1940 said defendant Tony Rodrigues operated a still at a place known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

FRANK J. HENNESSY

United States Attorney

Approved as to Form:

R. B. McM.

[Endorsed]: A true bill, Edward J. Dollard, Foreman. Presented in Open Court and Ordered Filed May 6, 1941. Walter B. Maling, Clerk. By C. W. Calbreath, Deputy Clerk. [5]

[Title of District Court and Cause.]

VERDICT

We, the Jury, find Raymond H. Jehl, the defendant at the bar

Guilty on Count No. 1

Guilty on Count No. 2

Guilty on Count No. 3

Guilty on Count No. 4

Guilty on Count No. 5

Guilty on Count No. 6

Guilty on Count No. 7

Guilty on Count No. 8

Guilty on Count No. 9

WALTER F. TITUS

Foreman

[Endorsed]: Filed, June 27th, 1941, at 3:40 P.M.
Walter B. Maling, Clerk. By C. W. Calbreath,
Deputy Clerk. [6]

District Court of the United States Northern Dis-
trict of California Southern Division

No. 27235-S Criminal Indictment in Nine Counts
for violation of (R. S. 3258) 26 USCA 2810(a);
(R. S. 3259) 26 USCA 2812; (R. S. 3260) 26
USCA 2814(a)(1); (R. S. 3281) 26 USCA
2833(a); (R. S. 3282) 26 USCA 2834; 26
USCA 3321, and 3320; 18 USCA Sec. 88.

UNITED STATES

v.

RAYMOND H. JEHL

JUDGMENT AND COMMITMENT

On this 27th day of June, 1941, came the United
States Attorney, and the defendant, Raymond H.
Jehl, appearing in proper person, and by counsel
and,

The defendant having been convicted on verdict

of guilty of the offenses charged in the Indictment in the above-entitled cause, to-wit:

Count One, possessing an unregistered still in violation of § 2810(a) of the Internal Revenue Code;

Count Two, engaging in the business of a distiller of alcohol and wilfully failing to give the notice required by § 2812 of the Internal Revenue Code;

Count Three, wilfully failing to give the bond prescribed by §2814(a)(1) of the Internal Revenue Code;

Count Four, distilling, with intent to defraud the United States of the tax on the spirits distilled in violation of §2833(a) of Internal Revenue Code;

Count Five, knowingly making fermented mash and wort fit for distillation in violation of §2834 of the Internal Revenue Code;

Count Six, knowingly separating by distillation alcoholic spirits from fermented mash in violation of §2834 of the Internal Revenue Code;

Count Seven, depositing and concealing alcohol and whiskey upon which taxes had been imposed, with intent to defraud the United States in violation of §3321 of the Internal Revenue Code;

Count Eight, possessing alcohol and whiskey with intent to sell in fraud of law in violation of §3320 of the Internal Revenue Code;

Count Nine, conspiring to violate the Internal Revenue Laws of the United States in violation of 18 USCA §88.

The indictment charges that the offenses alleged

therein were committed on the 28th day of August, 1940, at a place known as the E. A. Hall Ranch, Route 1, Box 77A, Watsonville, Santa Cruz County, State of California, within said Division and District.

And the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, It Is by the Court

Ordered and Adjudged that the defendant, having been found guilty of said offenses, is hereby committed to the custody of the Attorney General for imprisonment in an institution of the Penitentiary type to be designated by the Attorney General or his authorized representative, [7]

Upon Count One of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Two of the Indictment to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of One Thousand and No/100 Dollars (\$1,000.00);

Upon Count Three of the Indictment for the period of Two (2) Years and pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Four of the Indictment for the period of Two (2) Years and pay a fine to the United

States in the sum of One Hundred and No/100 Dollars (\$100.00);

Upon Count Five of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Six of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Seven of the Indictment for the period of Three (3) Years;

Upon Count Eight of the Indictment to pay a penalty to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Nine of the Indictment for the period of Two (2) Years;

It Is Further Ordered that the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, Six, and Nine, run concurrently; that the period of imprisonment imposed on the defendant on the Seventh Count of the Indictment begin and run from and after the expiration or execution of the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, and Six of the Indictment;

It Is Further Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified of-

feer, and that the same shall serve as the commitment herein.

A. F. ST. SURE

Judge

Entered and Filed this 27th day of June, 1941.

WALTER B. MALING,

Clerk

By C. W. CALBREATH

Deputy Clerk

Examined by:

W. F. MATHEWSON

Assistant United States
Attorney

Entered in Vol. 32 Judg. and Decrees at Page
451-452. [8]

[Title of District Court and Cause.]

BILL OF EXCEPTIONS OF DEFENDANT,
RAYMOND H. JEHL

Be It Remembered that heretofore and during the March 1941 term, the Grand Jury of the United States in and for the Northern District of California, First Division, did present and return in and before the above entitled Court its indictment against the above named defendant; that said indictment was filed in said Court and thereafter said defendant was duly arraigned as shown by the record on file in the above entitled Court; and

Be It Further Remembered that thereafter the defendant entered a plea of not guilty and that on

June 24, 1941, the above entitled cause proceeded to trial before the Honorable A. F. St. Sure, United States District Judge, before a jury, the United States being represented by the Honorable Frank J. Hennessy, United States Attorney in and for the Northern District of California and Valentine Hammack, Esq., Assistant United States Attorney, and the defendant being represented by James B. O'Connor, Esq., and Sol A. Abrams, Esq., said cause having been called for trial, the Court directed the filling of the jury box with proposed jurors. Thereafter, the Court [9] stated the nature of the case and questioned the jurors as to their qualifications, at the conclusion of which challenges having been exercised both by the United States and by the defendant, the jury was duly empanelled and sworn to try the cause.

Thereupon, the jury having been sworn, the United States to maintain the issues on its part to be maintained called as its first witness Sam G. Byrd.

Testimony of

SAM G. BYRD

for the United States

Sam G. Byrd, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Sam G. Byrd and I am an investigator of the Alcohol Tax Unit of the United States Treasury Department. In connection with my duties

(Testimony of Sam G. Byrd.)

at times I act as a photographer for the Department. On August 28th, 1940 I had occasion to go to the E. A. Hall Ranch which is on Route 1, Box 77-A about three miles from Watsonville, California. When I arrived at the premises I saw there an alcohol distillery, together with mash vats. At that time I took pictures of the distillery and vats. Again on June 20th, 1941 I went to the premises in question and took more pictures. The picture you showed me marked in red ink "1" is the picture of a copper still with column and that picture was taken inside of the barn on the premises in question on the 29th day of August, 1940. The picture you show me marked "2" is the upper part of the still known as the condenser, taken at the same time and place. The picture you show me marked "3" is a picture of the mash vats taken on the same premises at the same time and place. The picture you show me marked "4" is the barn in which the still was located, taken at the same time and place.

[10]

Whereupon, the pictures that had been identified by the witness were offered and received in evidence as U. S. Exhibits, 1, 2, 3 and 4.

The picture you now show me is a picture of the ranch premises consisting of the ranch residence, the tank-house and the barn in which the still was located. That picture was taken on the 20th day of June, 1941. That picture reflects the same position and condition that existed on these premises on

(Testimony of Sam G. Byrd.)

August 29, 1940. The tank-house, barn and living house are in the same position when this picture was taken as they were on August 29, 1940. These pictures represent the position and condition of the buildings they denote as they existed on August 29th, 1940. Whereupon, the photographs identified by the witness were received in evidence as U. S. Exhibits 5 and 6.

Cross Examination

Government's Exhibits 1, 2, 3 and 4 which show the still and the barn from the outside with the doors open were taken by me. At the time of taking the pictures, I opened the door to the barn. When the door is closed, no part of the still can be seen. However, when the door is open, part of the still can be observed.

Testimony of

CLAY GAINES

Clay Gaines, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Clay Gaines and I am a special investigator of the Alcohol Tax Unit of the Bureau of Internal Revenue and I was so employed in the month of August, 1940 and have been with that Department of the United States Government since 1928.

(Testimony of Clay Gaines.)

On August 28, 1940 I had occasion to go to the E. A. Hall ranch [11] outside of Watsonville. I went there about nine o'clock in the evening and was accompanied by Special Investigator Johnson, Investigator Harkins of the Alcohol Tax Unit, Investigator Beck and Special Investigator Farley of the State Liquor Control Division. At considerable distance from the E. A. Hall ranch we could get an odor of distillation and could also hear a burner. That would be approximately from 250 to perhaps 300 or 400 feet from the barn where the still was finally seized. I first got the odor of distillation when I was about 300 feet away, at least and I detected the sound of the burner approximately 250 feet away from the barn. We thereupon entered the barn and seized the distillery. The sound and smell that we obtained prior to entering the barn was not obtained on the E. A. Hall ranch, but was obtained from the property adjoining it. We thereupon went into the barn from the car and found this illicit distillery and arrested Tony Rodrigues who was in the upper part of the building mixing mash. I identified the defendant in court, Tony Rodrigues, as the person we saw in the barn that evening. At the time of entering this barn, the distillery was actually in operation. The still which we found was what is commonly known as a 500-gallon capacity pot cooker type and it was capable of producing about 500 gallons of alcohol a day. However, at the time it was seized it was not doing

(Testimony of Clay Gaines.)

that much because the mash capacity of the still was only 6000 gallons and they were actually producing about 160 gallons of alcohol a day, that is high proof alcohol. The still itself was located toward the front of the barn in a pit that was dug out and the column extended through the first floor into the second floor of the building and the mash vats were on the second floor. There were three 2000-gallon capacity vats and they were full. [12] We also found 110 gallons of alcohol, that is first run alcohol which we call whiskey. We also found motors, can and sugar and pipe and all of the necessary equipment to operate an illicit distillery. The electricity came to the barn from an underground cable which ran from the tank-house, it ran underground from the tank-house to the barn and then inside the barn and then was wired overhead. We also found an underground water supply system which ran from the tank-house about approximately 75 to 85 feet to the barn. From the corner of the distillery the mash was disposed of by a pipe which ran at an angle, perhaps 300 feet and emptied into an old lake bed that is back of the barn. At the time of the seizure of the distillery there was no water in the lake. The pipe that I refer to carried the mash from the lake, ran underground. We also found two or three hundred-gallon oil drums. A fuel line ran from the tank-house underground to the still.

(Testimony of Clay Gaines.)

About midnight of the night of the seizure of the still, the defendant Woodworth drove into the premises with his wife and a lady, I understood to be his stepdaughter and he was placed under arrest at that time. We placed him under arrest and took him into the still barn and there we questioned him. Woodworth stated that he had leased the premises to an Italian whom he could not describe and that he had seen him but the one time when he leased the premises to him. When I say the premises, I mean the barn. They leased it for \$20.00 a month and at first, Woodworth claimed he had no knowledge whatsoever of the still being operated in the premises. After we had talked to Woodworth for approximately thirty to forty minutes he made a statement in which he said, "We have had a lot of trouble with the still and have had to shut it down." The still did not occupy the entire part of the barn. [13] Directly bank of the still there was a partition and then there was a little runway with a small hole cut in the door, probably three feet square and there were a couple of pigs in there. The hole was cut in an old door, I imagine that it was not more than three feet square, just large enough for the pigs to go in and out.

This still was operated illegally and was not operated by permit nor was it operated under the regulations of the Internal Revenue Department. There were no tax stamps on the 110 gallons of whiskey that we found there. The taxes on 160 gallons of

(Testimony of Clay Gaines.)

alcohol would be about \$900.00 to \$1000.00 a day. I would estimate the cost of putting up a still of the type we found on the Hall ranch would be approximately between two and three thousand dollars, perhaps \$2500.00.

Cross-Examination

I am familiar with U. S. Exhibit 7 which is a drawing. I refer to the drawing which it has just been stipulated it might be introduced in evidence. The drawing which you show me depicts the position of the various buildings which were on the ranch on that day, that is, the tank-house and the barn, the barn being marked 24 feet by 29 feet. There is a road that is shown on this drawing which runs from the highway and which goes up to the house. There is also a road which goes from the house up towards the barn. When we entered these premises on the night in question we did not come up the road by the house but entered about a quarter of a mile back of the barn and came across an open field. I would say that we came upon the premises from a point about a quarter of a mile south of the barn; in an easterly direction from the premises there is some rolling country. About three or four miles easterly from these premises is the so-called Hecker Pass that goes to Gilroy and Morgan Hill. About two or three [14] hundred feet away from the premises in a westerly direction is a lake surrounded by more or less of a rolling terrain.

(Testimony of Clay Gaines.)

When Mr. Woodworth drove into the premises at about midnight, he drove up directly to the side of the house which is on the westerly side of the barn. We placed Mr. Woodworth under arrest and his wife and stepdaughter went into the house. Mr. Woodworth did not tell us that Rodrigues had rented the barn to an Italian. Mr. Woodworth did not say to us, "They have had trouble with the still, that it had broken down", what he did say was, "We have had trouble". I made a note of what he told me at that time. At that time he substantially told me that he had no interest whatsoever in the still and I asked him how he could possibly live on the premises within a hundred or a hundred fifty of it and not know there was a still there, but he said that he did not know there was a still there at any time. I don't recall exactly what the balance of the conversation was, but I do recall that during the course of the conversation, he said, "We had trouble with the still", and I wrote that down. Outside of the barn there was a runway in a door with a hole cut through it for the purpose of permitting the pigs to come in. Outside there were troughs for the purpose of feeding the pigs. At the time we placed Woodworth under arrest, he was dressed substantially as he is now, that is, with Western clothing. The electric wiring ran overhead from the highway to the house and from the house to the tank-house and then it ran underground from the tankhouse to the barn. I testified at the last trial

(Testimony of Clay Gaines.)

that the wiring from the house to the tank-house was underground, but I was incorrect. The electric wiring from the house to the tank-house was over-ground. The house where the Woodworths live was a very small shack. I do not recall Woodworth telling us that he and Rodrigues [15] had originally leased the premises for the purpose of raising hogs. After you call my attention to my testimony at the former trial, I now state that it appears in the transcript at the former trial that I said that he told me they were going to use the place to raise pigs, that he must have so told me. We did not make a search of the house that Woodworth lived in. I personally did not find any clothing on the premises. The questioning of Woodworth took place in the barn. We questioned Woodworth for about thirty minutes, then later there was casual conversation with him that took about an equally period of time. We were about three hundred feet away from the still when we got the odor of distillation and about fifty feet closer when we heard the noise of the burner. During the conversation that I had with Mr. Woodworth on the night of the seizure of the still he did not tell me that he had been engaged in hauling scrap iron, but he did tell me that at a later time in Salinas.

Redirect Examination

I was upon the premises in question on the day after the still was seized. From my observation there were no farming activities on the premises.

Testimony of
CHARLES B. HALL

Charles B. Hall, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Charles B. Hall and I live in Watsonville, California, and am engaged in the real estate and insurance business and was so engaged on or about the 1st day of March, 1940. My father owns a ranch right outside of Watsonville which is known as the E. A. Hall Ranch. [16] This ranch is situated about three miles from Watsonville. In April or March of 1940 we leased this ranch to Mr. Rodrigues and Mr. Woodworth, both of whom I identify as being two of the defendants now on trial. We talked to Woodworth and Rodrigues in our office concerning the leasing of these premises. The lease that you show me which is dated March 9, 1940 is the lease that they entered into with us at that time. At that time they told us they were going to use the ranch for a hog ranch, that they were going to raise corn and beans and hogs. From the time they started to build the house on the ranch until the still was seized, I was out to the premises about eight times. On most of the occasions when I went to the premises, I saw Mr. Woodworth. After the house had been built, on several occasions I went out there and asked Mr. Woodworth when they were going to start ranching. I did not see any corn or beans planted there but I did see two hogs on

(Testimony of Charles B. Hall.)

the premises. When I questioned Woodworth as to why he was not farming the place, he told me on one occasion that it was too wet and then later when I went out there about two weeks later, he said it was too dry.

Cross Examination

I first talked to Rodrigues about the leasing of the premises and did not know Woodworth until the day the lease was signed. They told me that they intended to raise hogs on this ranch. I do not recall that they told me that they were trying to get a garbage disposal contract from Camp McQuaide. I won't say they did tell me that or won't say that they did not. As far as I remember, from the time I leased the premises until August 28, 1940 I was upon the premises about six or eight times. I used to go out there with my father for the purpose of getting some eucalyptus that my father used to feed some parrakeet [17] birds that he had in his backyard. I was to receive our first payment for rent on July 1st, 1940. The total rent was to be \$175.00 for ten months. The lease was entered into on March 9, 1940 and the first payment of \$100.00 was to be made on July 1st, 1940 and the second payment of \$75.00 on December 1st, 1940. I saw Mr. Woodworth at the premises when the house was built. The first payment of \$50.00 was made on July 8 and the second payment was made on August 13th. I did not speak to Mr. Woodworth after August 13th about the lack of farming, because it was too late. I do not

(Testimony of Charles B. Hall.)

know whether Mr. Woodworth spoke to my father about raising hogs on the ranch but I imagine he did. Mr. Woodworth continued to live on the premises in question until the expiration of the lease which was in December, 1940. Under the terms of the lease Woodworth and Rodrigues had the right to remove the house they had built upon the expiration of the lease. However, if we so desired, we could retain the house on the premises by paying them the actual cost of the lumber. The house was not removed from the premises because we brought suit for damages and attached the property. I think it was approximately six weeks before the still was raided that we were last upon the premises. When we entered the premises we would drive up to the house on the road from the highway that entered the ranch. We never went into the house, but were practically at the house. They had a dog there and I did not like the looks of it so I never went into the place. I possibly went by the tank-house. At no time while I was on these premises did I smell the distillation of alcohol nor did I smell mash but if I had it, there would have been something doing, nor did I at any time hear any unusual noise upon the premises nor did I at any time observe a still in operation. [18]

Redirect Examination

The dog that was on the premises was a big police dog. On one occasion I was told that it was too dry

(Testimony of Charles B. Hall.)

to farm and later I was told it was too wet. I made an investigation of my own. I went down to look at the cow barn and there was nothing in there but a horse. The place was not farmed and it looked like a wreck.

Recross Examination

On occasions when we went there, we would take old cans with us and dump them on the premises. The other barn that I refer to was about 100 or 150 yards below the lake. We used to have a pumping plant there, but we took that out and there was a big pit there and it caved in and we used to go down and fill in cans there.

Testimony of

FRANK THOMAS

Frank Thomas, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Frank Thomas and I am the District Manager of the Coast Counties Gas & Electric Company and was such during the year 1940. I have brought with me some original records in connection with service on April 2nd, 1940 for Route 1, Box 78 in Watsonville. This document which you show me is an application for electric service under the name of L. A. Woodworth, address, Route 1, Box 78. The other document that you show me is a meter reading

(Testimony of Frank Thomas.)

slip for the same address. The first meter reading started on April 2nd, 1940. For the first three months, the meter readings were normal and during July and August they were above normal. July ran 223 kilowatts and June ran only 70 kilowatts.

Whereupon the application for service and the meter reading [19] slips were offered in evidence and received as U. S. Exhibit 9.

Testimony of

EDWARD C. HARKINS

Edward C. Harkins, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Edward C. Harkins and I am an investigator with the Alcohol Tax Unit of the United States Internal Revenue Bureau and I was employed as such during the year 1940. On the 28th day of August, 1940, together with other investigators, I had occasion to go to the E. A. Hall ranch near Watsonville. We went there about 9:45 in the evening of that day. Special Investigator Johnson and State Officer Beck and myself left the others in the party and walked about a mile to the ranch and circled the buildings on the ranch. There were several buildings on the ranch, a small house, a tank-house and a barn and a couple of sheds. We circled around to the north at some distance, and then ap-

(Testimony of Edward C. Harkins.)

proached the barn from the rear. Our intention was to locate what building the still was in definitely, and determine whether it was in operation at the time. We found that the still was in the barn and that it was in operation. I *as* about 500 feet away when I first got the odor of fermenting mash and distillation, and at that time I could hear the noise of a pump. As we approached closer I could hear the noise of the burner or the various noises of the still in operation. We then returned to meet the other officers and we informed them that we had located the still and that it was in operation. After that we returned and surrounded the barn and Johnson and myself entered the barn and arrested Tony Rodrigues, whom I identify as being one of the defendants on trial. In the barn we found a 500-gallon [20] capacity still with a column about twenty feet long and 6000 gallons of mash with two, what we call, runoff tanks, one about 100 gallons capacity and the other about 300 gallons capacity, and there was a mixing vat, hydrometer, hose, sugar, yeast and all the other things connected with the operation of a still. Investigator Johnson was with us on that occasion and has been transferred to Alabama and is no longer located in this district. The map which you show me was drawn by me and is fairly accurate from the measurements that I made. On this map I indicate to you the house and the tank-house. The distance from the house to the tank-house is 44 feet and the distance from the

(Testimony of Edward C. Harkins.)

tank-house to the barn is about 76 feet. The distance from the house itself to the barn where the still was is approximately 128 feet. The barn is a two-story barn and the vats were upstairs in the attic. There was a solid *petition* in the barn and in that *petition* was a pig pen in which were two pigs. I would say that the corral would be about 30 feet square and about 50 feet long. That evening we arrested the defendant Woodworth shortly after midnight. We had arrested the defendant Rodrigues about 11:15 at night and shortly after midnight State Officer Farley and I arrested Woodworth when he entered the premises. Woodworth drove up the road to the house and he was along the side of the house where he parked his car when he was taken into custody. After taking him into custody, we took him over to the barn where the still was. During the night I had several conversations with him. As we walked over to the barn, Woodworth told us that he had rented the barn to a small slender man that might be an Italian for \$20.00 a month, and then later on during the evening I spoke to him a number of times and on one occasion I made some remark that he [21] must have made a lot of money out of their operating for some time and he said, "No, we have a lot of trouble with the still and it did not run regularly." That was all the conversation I had with regard to the still. This distillery was not operated under government supervision. We found 110 gal-

(Testimony of Edward C. Harkins.)

lons of first-run stuff about 140 proof and 10 gallons of 90 proof. This was all untax-paid.

It was thereupon stipulated that the still was seized upon the premises and that the samples taken there consisted of five bottles and that they contained alcohol. The samples of alcohol were introduced in evidence and marked as Government's Exhibit 10 in evidence.

Cross Examination

On the night in question I went to the premises on two occasions. First with Officer Beck and Johnson, and secondly, with Farley, Gaines, Johnson, Beck and myself. I am not sure about the compass directions but I would say that we approached the still from the east and the second time we approached it from the same direction and when about 500 feet away I smelled the odor of distillation and heard the noise of a pump. There was a rather steep slope behind the barn and as we approached within a hundred feet of it, we could hear the burners. The partition that separated the pig pen from the rest of the *bar* was a solid partition and ran from the floor of the first floor to the ceiling. I was in and out of the barn while Mr. Gaines was questioning Woodworth. I did not stay there continually and I believe that it was after Mr. Gaines had questioned Woodworth that I went in and had some conversation with him at various times during the night. I am not certain whether Mr. Gaines was present

(Testimony of Edward C. Harkins.)

when Woodworth told me he had trouble with the still but I believe that he was. From my experience [22] as an agent with the Alcohol Tax Unit, I believe that mash causes stains on clothing. I don't believe it puts permanent stains, I believe they can be washed out. If fresh mash is on clothing, it definitely gives a strong odor. There were about 6,000 gallons of fresh sugar mash on these premises.

Redirect Examination

I saw the electric and pipe line and the oil line underground and I also saw another underground pipe line running from the still to the lake.

Recross Examination

These pipe lines were approximately shallow, that is not to exceed six inches underground. When Mr. Woodworth drove up to the premises I did not smell any odor of mash on his clothing. When I saw him, he was dressed in a cowboy attire.

Further Redirect Examination

The pipe that I refer to as running into the lake connected with the cooker of the still and ran diagonally into the lake from behind the house.

Testimony of
EDWIN L. BECK

Edwin L. Beck, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Edwin L. Beck and I am a Liquor Control Officer of the State of California. I was employed as such during the year 1940. On August 28th, 1940 I had occasion to visit the E. A. Hall Ranch near Watsonville with the other officers. We went there the first time about 9:45 in the evening. I saw the defendant Rodrigues in the still house that night. I identify him as the defendant Rodrigues on trial [23] in this court. I also saw the defendant Woodworth there that evening. I saw him when he was brought in by the Federal officers into the barn. I also identify the defendant Woodworth as being the person I have reference to. After having seen Woodworth in the barn, I later had a conversation with him in an automobile parked near the barn. That was approximately an hour after the conversation with him in the barn itself. Woodworth told me that he had first met Rodrigues about two years before this evening when he first went to work in the Springfield district south of Watsonville. He told me he had leased the ranch from a real estate man by the name of Hall in Watsonville and that his intention was to raise hogs and when the still deal came along, he gave up that idea. He told me that the Ford Coupe belonged to his

(Testimony of Edwin L. Beck.)

wife, that it was registered to her as the owner and that the Model-A Ford belonged to someone else, that it wasn't paid for. I asked him if he used either of these vehicles for transporting materials to the still and he said, no. On the following day Officer Johnson drew my attention to the back end of the Ford and in it we found grains of sugar on the floor. The Ford I am now referring to is the Ford Coupe.

Cross Examination

Mr. Woodworth answered my questions readily and he told me that he had intended to raise hogs on the ranch originally. He told me he had made some arrangements with the sergeant at Camp McQuaide about garbage but something happened to the arrangement. He told me that the arrangements he had made had fallen through and that the still deal came along and he gave up the idea of raising hogs. He did not tell me that when his proposed contract with Camp McQuaide fell through that he decided to give up the hog raising. He said he had made arrangements [24] with someone to get him garbage and that the deal fell through. He did not tell me that he used the Ford to haul materials for the still. Three or four days later after the arrest he told me that he used the Ford truck in the business of hauling scrap iron. I questioned him for possibly twenty or thirty minutes. We talked about many things, horses and things like that. We were sitting in the car for quite a while, I don't know

(Testimony of Edwin L. Beck.)

just how long it was. I saw him about a week later and had a conversation with him. I talked to him on August 28th and he did not tell me anything about farming the place or the ranch where the still was, that he just mentioned hog raising.

Testimony of
EARL GOON

Jehl

Earl Goon, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Earl Goon and I reside in Watsonville, California, and am in the grocery business and I operate what is known as the "Independent Grocery" located at 159 Main Street, Watsonville, California. I was in that business in 1940. I know the defendant Raymond Jehl. Sometime in May or June, 1940 Raymond Jehl came to my grocery store and I had a conversation with him. He asked me at that time if he could buy sugar in ten-sack lots and I said, yes. We discussed the price. I mentioned a price a little higher than I usually charge. At that time he said to me, "Let me know when you want it." Thereupon the witness identified the defendant Raymond Jehl as the person to whom he was referred in his testimony.

About three weeks he came to my place and placed an order for sugar, that is for ten sacks and

(Testimony of Earl Goon.)

he told me that someone would pick it up. He did not say when it would be picked up but subsequently a day or so later, someone did pick it up. That person was Tony [25] Rodrigues whom I now identify in the courtroom.

About a week after the occasion upon which I first sold him sugar, I sold him sugar again and at that time I also sold him ten sacks for which he paid me and the same thing happened again, Tony came and picked it up at night. About six o'clock in the evening. When the sugar was ordered, I would put it in the back room and then Tony would come and get it. There is an alley way in the rear of my store where a truck can come up to the rear of the store. When Tony came for the sugar, he would come in the alley way. Mr. Jehl paid about three times and Tony paid for it about three times. Mr. Jehl ordered sugar and paid about three times and Tony paid about three times. When Tony would pay for the sugar, the sugar had already been ordered by Mr. Jehl. Mr. Jehl ordered the sugar in all instances.

Sometime in June I had a long distance telephone call with Mr. Jehl in connection with sugar. At that time he ordered sugar over the phone and said someone would pick it up. In all I made about six different sales of sugar between May and the first of August.

I remember reading in the paper about a still being seized by the Federal officers on the Hall

(Testimony of Earl Goon.)

ranch. A few days after I read about the still being seized, Mr. Jehl came to see me and he told me at that time not to worry. I had told him a couple of Federal officers were there to check on me and he told me not to worry, that it was just a routine matter. The defendant Woodworth, whom I identify in the courtroom, came and picked up the sugar on one occasion. Mr. Jehl had ordered the sugar that Woodworth picked up. All the sugar that was picked up at my place was picked up in the evening.

Cross Examination

I have lived in Watsonville for approximately twenty-seven years [26] and the business that is now being conducted by my brother and myself was previously conducted by my father. I did not know Mr. Jehl over a period of years, I had hardly met him. I had seen him in the store. I had not been introduced to him. I did not know him very well. My father had done business with him in regard to his insurance. He wrote my father's insurance and he also writes insurance for me, and at the time of these transactions, he was writing insurance for me. On the first time that he came to see me, there was another fellow with him. I don't know his name. I think he introduced me to the other man but I didn't pay any attention. Upon the occasion when he came to see me with this other man, Jehl asked me if he could purchase sugar in lots and I said, yes. Both said it, I think Mr. Jehl said it. The other

(Testimony of Earl Goon.)

man who was with him didn't ask that question. No, he did not. I did not ask him what he wanted sugar for and he did not tell me what he wanted it for. There was no conversation about the sugar being used in connection with a distillery. In none of the transactions I had with Mr. Jehl concerning sugar was there ever any mention of the sugar being used in connection with an illicit distillery. The first conversation I had with him consumed about five or ten minutes. There was no sugar ordered at the first conversation. I never saw the other man again. I first interviewed by the Government agent in connection with this case shortly after the still was raided. I think the Government agent that interviewed me was a Mr. Johnson and there was another officer with him at that time. At that time I made a statement to them concerning the purchase of the sugar that was sold by me. At that time I did not tell them that there was another man with Mr. Jehl. The reason I did not tell them that because I was talking to Jehl all the time. I did not mention to Mr. [27] Johnson anything about the other man in connection with the sugar. I only saw the other man on one occasion. Mr. Johnson showed me some photographs at the time I was interviewed, but I did not identify the other man in any of those photographs. I think all of the sugar was ordered by Mr. Jehl. I am pretty sure that it was. Shortly after I was interviewed by the Government agent, Mr. Jehl came to see me and I told him that I had

(Testimony of Earl Goon.)

been interviewed by the Government agents and told him what I had told the Government officers. I told him that I had told the Government officers that on several occasions he, Jehl, had arranged for the purchase of sugar from me. At that time Mr. Jehl told me it was a routine investigation. He did not mention anything about a still. He did not tell me what to tell the Government officers or not what to tell them. The only records I kept of the purchase of the sugar were the purchases that I myself made from wholesalers. My records do not show to whom sugar was sold. I did not know that I was under an obligation to keep a record of sales of sugar for the Government. At the time these purchases of sugar were made, the retail price was about \$5.25 and I charged about \$5.50. If the records show that I testified in the last trial that the retail price at that time was around \$5.00 and that I charged about \$5.20 for it, that would be the correct price. I was charging about 20¢ more a check than the retail price. It is a common practice for me to charge a higher price if I can get it. I did not know Mr. Woodworth's name, part of the time he came to pick up the sugar, but I had seen him on the streets. He told me that Tony had sent him over to pick up some sacks because Tony's car had broken down.

Redirect Examination

Mr. Woodworth said that Tony had sent him over to get sacks, to pick up the sugar and I took him

(Testimony of Earl Goon.)

around to the back and gave him the [28] sugar in the back room, that's correct.

Recross Examination

When Mr. Rodrigues came to receive sugar, he paid for it on several occasions, that is, two or three times, and on the other occasions it was paid for by Mr. Jehl. I do not remember any occasion when Mr. Rodrigues ordered sugar. I was born in Watsonville and have lived there all my life and attended public and high school there and I am a graduate from high school there.

Testimony of

JOE CARRILLO

Joe Carrillo, called as a witness on behalf of the United States, being first duly sworn, testified substantially as follows:

My name is Joe Carrillo and I reside in San Jose, California and I lived in San Jose during the year 1940. I am familiar with the Colonial Inn which is located three miles south of San Jose on the Monterey highway. It is a restaurant and night club. I worked there on occasions in 1940. I first started working there sometime in the latter part of June or the first of July and at that time the Colonial Inn was owned by Raymond Jehl, whom I see in the courtroom and who I identify. I worked for Mr.

(Testimony of Joe Carrillo.)

Jehl at the Colonial inn as a musician. I remember having a conversation with the defendant Jehl sometime in the latter part of August or September. I would say it would be around the first of September. There was present at that time and conversation Mrs. Carrillo, the bartender and myself and a few others in the house. Mr. Jehl at that time was talking to my wife, who was working at the Colonial Inn. The conversation took place at the bar. I don't know what the whole conversation was, but when I came up, they were talking and I overheard he was saying he was kind of in the dumps, that is Mr. Jehl was saying he was kind of in the dumps. He was talking to Mrs. Carrillo about how down in the dumps he was and she asked him what for, [29] and he said, "I had to go to San Francisco and get some of my men out of jail. It made me feel bad, cost me some money." At that time I got up and left. He said the men he got out of jail were arrested for running a still. He said, "It was my still". I do not remember any more of the conversation because I got up and left.

Cross Examination

At the present time I am a collector for the San Jose Evening News. I am also a drummer and I have worked in various night clubs around San Jose. During the period of time I referred to in my direct examination, my wife was employed as a waitress in the Colonial Inn. I first met Mr. Jehl

(Testimony of Joe Carrillo.)

around May or April of 1940. I was introduced to him by Mr. and Mrs. Kaiser at the time he took over the Colonial Inn. He was supposed to have a partner, but I think he was working for him. I don't know whether he had a partner or not. I first went to work for him in the latter part of June or the first part of July. He didn't dismiss me, I quit. I had a dispute with him over wages. I only worked for him a couple of months. I worked there four nights a week. I would not say that he was there every evening. Sometimes he was there and sometimes you wouldn't see him for a couple of days. After I left him employment, my wife continued to work for him and I visited the place frequently. I went there practically every day to take her to work and to later bring her home. Sometimes some friends would take her home at night, but most of the time I took her home. Mr. Jehl never told me point blank that he had a still but from the conversation he had with my wife, I gathered that much, that is, on the one occasion to which I have referred. Prior to the occasion to which I testified to on direct examination, there was no conversation concerning any still. In all of the time that I was on the premises, prior to [30] the conversation that I testified to on my direct examination, there was no conversation with Mr. Jehl in which he indicated to me that he was either directly or indirectly interested in a still. At the conversation to which I have referred, there was present my wife and the bar-

tender, whose name was Tony, I believe it was something like the name you mentioned, Amovich. At the time I came up and joined in the conversation, Mr. Jehl had been talking to my wife. The conversation was directed to my wife, but I happened to be present. When I came up to the conversation, Mr. Jehl said that he was in the dumps that night and Mrs. Carrillo asked what the trouble was, and he said, "I had to go down to San Francisco and bail out my men." And she said, "What was that for?" And he said, "They knocked over my still and picked them up and I had to go down and bail them out and oh, it cost a lot of dough." And he was down in the dumps about it. At that time the bartender was behind the bar. I don't know whether he was present at the conversation or not, but he was within hearing distance.

The first time I talked to the Government agents in connection with this case was sometime in January or February, 1941. That conversation took place at my home at 320 South Central Street, San Jose, California. I do not know who the agent was that came to see me at that time. I would know him if I saw him. The agent that came to see me was from the FBI. It was in connection with this case and Mr. Jehl that I talked to the FBI agent. I do not know who the agents were, but I am sure that they were agents of the FBI, they were agents from the Federal Bureau of Investigation. At that time I gave them a statement of the case. At that time they

(Testimony of Joe Carrillo.)

talked mostly to Mrs. Carrillo. I personally did not give them any statement in connection with the case but Mrs. Carrillo did. I did not tell them at that time that my being present at the conversation to which I have testified. I told them that [31] I was present at that conversation on the second occasion when he came to see me a little later at my home. It would be about three weeks later and it was the same guys from the FBI. He showed me his credentials and identification. The badge that you show me which was produced by Mr. Gaines is not the badge or the type of badge that was shown me by the FBI agent. I never talked to Mr. Harkins or Mr. Johnson, nor did I make a written statement in connection with my testimony in this case. I told the agents of my participation in the conversation that I have testified to on the second occasion when they came to see me. The Government agents are the only ones I have talked to in connection with my testimony in this case. I did talk to Mr. Hammack in connection with the case about two weeks ago in the courtroom and I talked to him outside of the courtroom too. I talked to him in the office of the United States Attorney upstairs. I do not bear any animosity towards Mr. Jehl and I feel quite friendly to him. I do not feel unfriendly towards anybody. I was here this morning at ten o'clock when the court opened. I saw the man whom I identify as the bartender by the door here this morning.

Testimony of

DELLA CARRILLO

Della Carrillo, produced as a witness on behalf of the United States, having been first duly sworn, testified substantially as follows:

My name is Della Carrillo and I reside at 272 E. San Salvador Street, San Jose. During the year 1940 I was employed in the Colonial Inn and I am still working there. I was employed as a cook, waitress, dish washer and hostess. I know the defendant Mr. Jehl whom I see in the courtroom. He was my boss at the Colonial Inn. He first came to the Colonial Inn in May of 1940 at which time he was the owner and up to September, 1940. The Colonial Inn is a night club. About a week before [32] Mr. Jehl went out of business at the Colonial Inn, I had a conversation with him there. That would be sometime in September, 1940. Present at the conversation were myself, Mr. Jehl, my husband and the bartender. At that time Mr. Jehl said that he had come to San Francisco to see about bailing out a couple of his men. Prior to the conversation to which I have just referred, I had another conversation with Mr. Jehl sometime in the first part of August. That conversation took place in the kitchen of the Colonial Inn. There was no one present except Mr. Jehl and myself. At that time, Mr. Jehl said, "It was awful to stand on a hill and watch thousands of dollars go to waste".

I again saw Mr. Jehl about three or four days

(Testimony of Della Carrillo.)

before the trial of this case, that is, before the other trial of this case. At that time I saw him at the Colonial Inn and he was there with Tony and the other man. By Tony, I mean the defendant Rodrigues, and the other man who is a defendant in this case, Mr. Woodworthy. They came there around ten o'clock in the evening. I was standing on the porch and they pulled up in a car and Mr. Jehl was driving. He had with him Mr. Woodworth and Mr. Rodrigues. They got out of the car and then Mr. Jehl called me over and I talked to Mr. Jehl in the car. He asked me if anybody had been to see him in regard to the trial and I said, yes. He wanted to know what they asked me and I told him that I had identified some pictures and then he said to me, "Remember you don't know anything." I remember another occasion in the latter part of August at the Colonial Inn when he told the bartender Tony, that he had to go away for a little while because things were getting hot and that he was going to Reno for two weeks. [33]

Cross Examination

I went to work in the Colonial Inn approximately in January 1940 and at that time I was employed by Mr. and Mrs. Kaiser. I continued to work there until the time that Mr. Jehl came into the premises about May of 1940 and I thereafter continued to work for Mr. Jehl until he left sometime in September 1940. I am the wife of Joseph Carrillo, the gen-

(Testimony of Della Carrillo.)

tleman who testified today on the witness stand. The first conversation I had with Mr. Jehl in connection with the still or anything concerning the still was sometime in the latter part of August, 1940. he said at that time, it was awful to stand on a hill and watch thousands of dollars go to waste. He didn't tell me what he meant by that and I didn't think it was any of my business, and he made no further explanation of that conversation. He didn't tell me what he was referring to and I did not ask him what he was referring to. The next conversation I had with Mr. Jehl would be sometime in September at which were present my husband, the bartender and himself. The bartender's name is Tony Amavich. At that time Mr. Jehl said he had come to San Francisco where he had bailed some men out and I asked him in regard to what and he said, in regard to his still. He did not in so many words tell me that it was his still. He used the words "my still". I may have said to him at that time, "Well, that is too bad." I usually do say that in a case of sympathy. From June 1940 until the conversation at which were present myself, my husband, the bartender and Mr. Jehl, there was nothing said at any time in connection with the still and a still was never mentioned to me. The only other conversation was the one in the first part of August when he said it was awful to stand on a hill and watch thousands of dollars go to waste. The first time I talked to any government agent in connec-

(Testimony of Della Carrillo.)

tion with this [34] case was about a week after Mr. Jehl went out of business. That conversation took place at my home at which were present my husband, myself, and the government officers. It would be sometime in September, 1940. The government officers to which I talked was a Mr. Johnson. He was alone at that time. I did not give him a written statement. The last conversation to which I referred as having talked to Mr. Jehl some few days prior to the last trial, there was no one present but Mr. Jehl and myself. At that time he asked me if anyone had been to see me regarding the case. He did not at that time mention a still. He told me that his trial was coming up. I told him that they had been to see me to identify some pictures, and he said, "Remember, you don't know anything." He did not ask what conversation I had had with the government agents. He did not tell me that he had come down there to see me at the request of his attorney, Mr. Abrams. At the time I had the conversation with Mr. Jehl in the kitchen, to which I have testified, I did not know to what Mr. Jehl was referring. At that time, I had not been told, either directly or indirectly, that Mr. Jehl was supposed to have an interest in a still. The first time that I had any information that he had an interest in a still was at the time when he told me that he *baled* some men out. At the time that he told me about bailing the men out, he said it was in connection with a still. After you have shown me the testimony that I gave

(Testimony of Della Carrillo.)

at the last trial in which I said that at the conversation to which I have referred about Mr. Jehl coming to San Francisco to bail some men out, that he did not at that time say anything about a still and that there was no talk about a still at that time, I will now say that if the record shows that that was my testimony in the last trial, I must have given that testimony. You know the first time being in Court you [35] can always remember a few things and I could state a few more things if I would like to. I do not deny that at the last trial I testified that I did not know that Mr. Jehl had a still and that nothing was said to me about him having a still and that I never knew he had a still and that he never talked about a still at any time.

Redirect Examination

The first time that Mr. Jehl talked to me about having come to San Francisco to bail some men out because they were working on his still was the first time that I knew he had any interest in a still.

Examination by the Court

I heard Mr. Jehl say to Mrs. Kaiser prior to taking the place over, "You don't have to worry about your rent, I don't care whether the business goes or not, all I want it for is a stopping place."

I understood he wanted it as a stopping place for he and his men to live in and I understood they weren't very much interested in the conduct of the

(Testimony of Della Carrillo.)

business itself. He told Mrs. Kaiser that she did not have to worry about taking in any money because he had money to pay the rent monthly. I recall when Mr. Jehl was located at the Colonial Inn, people coming in and turning what appeared to be large sums of money over to him. I do not know the name of this person. [36]

Thereupon, the United States rested its case.

The defendant, Raymond Jehl, through his counsel, moved the court for a directed verdict of not guilty.

The defendant, Jehl's, motion for a directed verdict of not guilty was thereupon by the court denied, to the denial of which the defendant Jehl regularly excepted.

Thereupon, the following witnesses were called on behalf of the three defendants upon trial.

Testimony of

FERDINAND C. BOCK

Ferdinand C. Bock, called as a witness on behalf of the defendant Woodworthy, having been first duly sworn, testified substantially as follows:

My name is Ferdinand C. Bock and I am by occupation a Military Property Custodian for the State of California at Salinas, California. During the early part of 1940 I was Military Property Custodian at Camp McQuaide out of Watsonville. I was

(Testimony of Ferdinand C. Bock.)

such during the months of January, February and March of 1940. I know the defendant Woodworth and have known him for about two and one-half or three years. Sometime in January or February, 1940, I saw Woodworth when he came to see me about either buying or selling a cow. I later saw him when he came down picking up scrap iron and metals and stuff of that sort. I had a lot of it and had him come out and get it. After that he came to see me at the camp, looking for garbage. I had had a conversation with the Supply Officer of the 250th Coast Artillery who used to come to Camp McQuaide for their training period with respect to the disposition of garbage. He asked me to find someone who would dispose of the garbage at the camp. Sometime in either April or March of 1940 [37] I had a conversation with the defendant Woodworth about the garbage disposal. Woodworth told me that he wanted the garbage because he was planning on raising some hogs and he intended to use the garbage to feed the hogs and I told him I would try to get permission for him. I personally had no authority to make a contract but I did attempt to secure a contract for him. I was not successful in my efforts to secure the contract. Sometime in the latter part of April or the first of May I told Woodworth that a firm had purchased the garbage contract and had paid for it.

(Testimony of Ferdinand C. Bock.)

Cross Examination

I am not in the United States Army but I am employed as a custodian of the State of California at Watsonville, California. I have known Woodworth for about two and one-half or three years. I first met him at Camp McQuaide where I was custodian at camp. I first discussed the garbage proposition with him sometime about March or April of 1940 at the camp. He told me he would like to have the garbage there and I told him I would try to secure the contract for him. There were no troops at camp in March or April but we expected some in May. I was informed that we could expect National Guard troops sometime in May. I was so informed through the Adjutant General's Office in San Francisco by a Captain Klein. Camp McQuaide is a National Guard Camp. It is sometimes used by the regular army. The regular army used it in January of 1940 and in November of 1940. Now I am wrong about that, the National Guard used it in November, 1940 and in 1939 the regular army, the 65th Coast Artillery used it in the months of May and June. In January of 1940 the Regular Army used it just for a few days. In July of 1940 the National Guard used it for three weeks. The 11th Cavalry of the United States Army was there for a few days in [38] January and the National Guard was there in July. Outside of these two troops, no other troops used the camp during 1940. There were no troops at Camp McQuaide during February, March, April

(Testimony of Ferdinand C. Boek.)

or May of 1940; outside of the 11th Cavalry and the National Guard there were no troops there during 1940 except a couple of one-night bivouacs when certain units came through and stayed one night. I remember these units as being the 250th Coast Artillery for one night and there was a reserve officers post came and looked over the camp. There were no troops there steadily until September of 1940.

Redirect Examination

I received a notification from the commanding officer in San Francisco that the troops were expected to come down there in May. They would come down quite frequently, sometimes they would stay and make camp and sometimes they would not. That was up to the commanding officers of the troops that made these trips. When these troops they came, they would bring their own feeding equipment and there would be garbage to be disposed of.

Recross Examination

I do not remember how long the commanding officer told me the troops would be stationed therein in May. He told me that they were coming down to bivouac. I don't remember whether he said one day or one week. From these one night bivouacs or stopovers there would be garbage to dispose of. I had planned to get the garbage disposal contract from the Supply Officer of the 250th Coast Artillery. At that time it was Captain Saul and later a Captain

(Testimony of Ferdinand C. Bock.)

Cook. He was the commanding officer of the service battery and he was also supply officer of the regiment. The officers always asked me to find someone [39] to dispose of the garbage because they did not want to pay for its disposal and I thought it would be a good deal for someone who was in the pig business or hog business or something of that type. I do not remember just when I was told that a national guard was coming down to Camp McQuaide permanently in the fall, but I think it was sometime in the early spring. I was told by several officers, Captain Klein was one of the officers. In the spring and before the draft became effective and before the National Guard was called into Service, Mr. Klein told me that they were coming down permanently into service. The National Guard were called into service on November 16, 1940. The drafted men went into service at about the same time.

Testimony of

LESLIE A. WOODWORTH

Leslie A. Woodworth produced as a witness in his own behalf, being first duly sworn, testified substantially as follows:

My name is Leslie A. Woodworth and I reside in Watsonville, California and have lived there for about four years; prior to going to Watsonville, I lived in Salinas for one year and before that I lived

(Testimony of Leslie A. Woodworth.)

in Cloverdale, Sonoma County, where I was born. I have resided in California most of my life but have been out of the state for short periods of time. I am married and have a stepdaughter. Our stepdaughter is eighteen years of age. I was married in September of 1934 and I have resided continuously with my wife and stepdaughter since that time. I went as far as the fourth grade in school. I went to **school in Sonoma County**. Since I have been fourteen or fifteen years of age I have been working on ranches as a ranch hand and as a stock man and at times I have raised hogs. I have also been ranching and have driven tractors on ranches. I know and also have been engaged in the business of collecting and selling scrap iron around Watsonville, [40] California.

I know the defendant Rodrigues who sits in the courtroom. I first met him about three years ago when he came to my house and wanted me to go to work driving a tractor. At that time I was living in a place called old Eureka Canyon, near Watsonville. I worked for Rodrigues on a ranch he had leased in Springfield near Watsonville. Rodrigues was the lessee of the ranch at that time and I was driving tractor for him. That was the first time I met him.

In March of 1940 Rodrigues entered into a lease with Mr. Hall for the Hall Ranch located near Watsonville, California. Prior to the entering into of this lease I had worked for Rodrigues driving team,

(Testimony of Leslie A. Woodworth.)

cultivating beans on his ranch. For about three months before I leased this ranch with Rodrigues, I had been hauling scrap iron around Watsonville. Rodrigues was also hauling scrap iron with me, that is, he was picking up scrap iron and I was hauling it to San Jose with my own and selling it there. At that time I was living on the Riverside Road in Watsonville. When I was living on the place at Riverside Road I was paying \$30.00 a month which was a little higher than I wanted to pay and Mr. Rodrigues mentioned the Hall place to me and said although he did not have a house on it, that we should go and see it, so we drove over to look at it, and Mr. Rodrigues said we could get it fairly reasonable. He said around \$150.00 or \$175.00 a year, so then we went down to see Mr. Hall and made a lease. I intended to use the place to live on and also to have enough roof to raise a few head of stock or hogs and maybe a few head of cows and I discussed the raising of hogs with Rodrigues, that during the conversation I had with Rodrigues as to the reason for taking over the Hall place. At the time we took it over there was nothing on there except a tank-house and two [41] barns. I did not meet Mr. Hall until the time we actually signed the lease and I don't recall having any conversation with Mr. Hall as to what we intended to use the ranch for. We started building the house right after we leased the place, within a few days after we leased it. Both of us bought and paid for the lumber and material that

(Testimony of Leslie A. Woodworth.)

was used in the house. It cost us around \$135.00 to \$150.00 for the lumber and material we put in the house. The labor was furnished by Rodrigues and myself. I moved into the house about two weeks or a month after that time when it was completed and that would be around the end of March or the first part of April. Previous to that time, I had intended to make arrangements for the disposal of garbage at Camp McQuaide with a Mr. Bock. I had known him for about two and one-half or three years prior to that time. I first talked to him about the garbage disposal shortly after I had talked to Mr. Rodrigues about leasing the Hall place. I went down to see him and he gave me a bunch of scrap metal and he was telling me about the camp and he told me how they had paid for the disposal of garbage the year before and that they were looking for someone who could use the garbage and would not have to pay for its disposal, so we began talking about it and I told him I would be interested in taking the garbage away from the camp for the purpose of feeding hogs. I talked to Mr. Bock about this on several occasions. He told me he would tell me what he had heard or that he was trying to get the contract for me. He told me he was quite sure he could get it and told me that he had been to San Francisco to see about the contract, that was sometime in the latter part of April. I had already moved into the house on the Hall ranch at that time. I thereafter made arrangements to secure hogs from my

(Testimony of Leslie A. Woodworth.)

brother. I told my brother about the possibility of getting the garbage at Camp [42] McQuaide and asked him if he would be willing to furnish me with the hogs so that I could use up the garbage. My brother lives in Solano County on the Sacramento Road. After I had been notified by Mr. Bock that someone else had the contract, I wrote my brother and told him I could not get the contract for the garbage disposal and had to let the hogs ride for a while until I could secure feed from someone else. At that time I was also engaged in hauling scrap iron. I worked practically all the time at that. During the time that I was building the house I would work three or four hours a day on that and the rest of the day I would work in the scrap iron business. I subsequently bought two hogs myself. During this entire period of time I was engaged in buying and selling scrap iron. We rented part of the premises to another person. We rented the barn. There were two barns on the premises, and we represented the one that is closest to the house, as I indicated on the map. We rented the barn around the first of June. Mr. Rodrigues told me that there had been a man in there who was interested in leasing the barn. He said the man was willing to pay \$20.00 a month for the rent of the barn and at that time things did not look any too promising and I had no use of the barn and I told Rodrigues that whatever he did in the matter was perfectly alright with me. I do not recall

(Testimony of Leslie A. Woodworth.)

that I saw the man who rented the barn. After the barn was rented, I never went to the barn myself.

I did haul on one occasion some sugar from the Independent Grocery to the Hall ranch. That was in the latter part of July. Mr. Rodrigues' car was broken down and he asked me if I would go to the Independent Grocery and pick up some sacks. He did not tell me what the sacks contained. He told me to go and pick up some sacks. I went to the Independent Grocery and saw Mr. Goon and I did pick up some [43] sacks. I told him that Tony had sent me to pick the sacks up and he told me they were right in the pile in the back of the building. At that time I picked up four sacks and I was using a '35 V-8 Ford Coupe at that time which was registered in my wife's name. The Ford truck that I had I used for hauling scrap iron. The sacks that I picked up had sugar stamped on them. I loaded them in the car and brought them out to the ranch and parked my car in front of the house and went in and had my breakfast, and Mr. Rodrigues was in the house at that time. He came out and when I came out after I had my breakfast, the car was parked alongside of the house where I usually park it and at that time the sacks had been taken out of it.

I would leave the house at various times to go on my business of collecting scrap iron, some-

(Testimony of Leslie A. Woodworth.)

times I would leave as early as four in the morning and the latest I would leave would be around seven o'clock. If I picked up a load sometimes I would return in the afternoon, but usually I got home around six or seven o'clock and sometimes eight o'clock at night. Up until the end of July, or up until the time that I picked up the sugar sacks for Mr. Rodrigues, I did not know that there was a still in the barn and I had not detected the odor of fermented mash or distilled alcohol. I do know what the odor of alcohol smells like. After the barn was raided I went to the barn. The closest I would go to the barn, as I remember, would be to the tank-house. There were two pigs there at that time and they were permitted to run around the corral. The place where the pigs were kept was partitioned off or separated from the rest of the barn. After the barn was leased or rented, I did not feed the pigs. Mr. Rodrigues took care of them because he was working there in the barn and he told me there would be no need for me to bother feeding the pigs, that he would take care of [44] them. After the barn was rented, Mr. Rodrigues told me he was working for the man who rented the barn, but did not tell me what he was doing for him. On August 28th I was placed under arrest when I drove into the ranch. The first time I knew there was a still in the barn was about the first week in August, about six or seven o'clock in the evening I heard an explosion like a bunch of cans

(Testimony of Leslie A. Woodworth.)

falling or something like that and I went out of the house to see what it was. Just as I got out of the house, Mr. Rodrigues was coming over to see me and I asked him what the noise was and he said he was having trouble with the still. That is the first time I knew there was a still there, and I said to him, "You mean to tell me there is a still there", and he said there was and I said, "That is not so good, it does not look good to me". I then told him that he was liable to get into trouble and he said, no that he was just working there, there was nothing wrong about that. That was all the conversation that we had.

On the occasion when I picked up the sugar at the Independent Grocery it was around eight o'clock in the morning. I heard Mr. Goon testify that it was eight o'clock at night, but he was wrong about that. I am certain that it was in the morning. At the time I was arrested Mr. Gaines talked to me for about thirty minutes, maybe forty minutes. He asked me about the still and I told him that I knew nothing about the still. He asked me if I had any interest in the still and I told him no, that I did not and I also told him that I knew nothing about the still at all. At that time I meant to tell him that I knew nothing about the operation or handling of a still or anything like that. I recall telling Mr. Gaines that Tony had told me that he had had trouble with the still. I don't recall whether I told him how I found out about the still and

(Testimony of Leslie A. Woodworth.)

I don't recall whether he asked me any questions [45] about my having hauled sugar. He asked me how I happened to be on the ranch and I told him that Mr. Rodrigues and I had rented the place together with the intention of raising hogs and that I was to get a contract at Camp McQuaide for garbage. I also told him about building the house and about Mr. Rodrigues helping me. I also had a conversation with agent Hawkins. In this conversation they talked about the ranch and then they would talk about the still and they talked about horses, cattle and farming and then they would lead back towards the alcohol and about the still. I do not recall that I told the officers that I did not know that there was a still there at all, but I do recall telling Mr. Gaines that Tony had told me that the still had broken down. I never at any time did any work on the still nor did I have anything to do with putting the still in or any portion of it. I have never been arrested before in my life and this is the first time I have ever been in court on this case. Tony did not tell me the name of the man to whom he had rented the barn, nor did he give me any description of the man.

Cross Examination

I leased this ranch with Mr. Rodrigues with the idea of starting a hog farm and that was sometime around the first part of March that leased the premises. Shortly after that we bought a couple

(Testimony of Leslie A. Woodworth.)

of hogs, I don't know it may have been a week or ten days after that. Prior to entering into the lease, I was only on the Hall Ranch once. At that time I looked over the property and looked over the barn. I did not go into the barn. I was in the corral. While I was building the house I do not recall having gone down to the barn. When I looked at the barn, it looked just like an ordinary barn. When [46] I looked into the barn, I saw that there were stalls in there. The window that I looked through is on the north side. I recognized the house that you show me in the photograph as being the tank-house. The barn door that you refer to, I think, was nailed up and I did not make any attempt to open it. I had two horses on the premises in the middle of July. There was a big horse and one colt. They were kept in the lower barn which is next to the lake and about one hundred feet away from the house. I kept the horses in that barn because the other barn was rented. I did not have the horses at the time the barn was rented. I got the colt from a man in Santa Cruz and the other horse I got from a horse dealer. I paid \$5.00 for the colt and \$25.00 for the horse. The compartment where the pigs were kept was already there when we went upon the premises. I did not know it was there because I did not see it because I had never been in the barn. I do not know who built the little opening for the pigs to go in and out. That was the way the barn was when I went into the place.

(Testimony of Leslie A. Woodworth.)

I fed the pigs when I first went there and I fed them in the corral. I would say that it is about thirty feet from the edge of the corral to the barn. I fed the pigs garbage from the house and I got some sacks of barley and I got some old apples I got from cold storage. The night I was arrested I saw electric lights in the barn where the still was. There were no lights in the barn where the horses were kept. I had no need for lights there. I had electric lights in the house and there was wiring from the house to the tank-house. I did not know there were any oil tanks around the tank-house. My electricity bill ran around \$3.00 a month, possibly a little more and possibly a little less. It is true that my electric bill went up about 100%. I had been using some water for the garden and had been pumping the water by electricity. The [47] garden was between the house and the tank-house. Sometimes I watered it but most of the time my wife watered the garden. In the evening while she would be watering, I would be sorting the scrap iron. Sometimes I would get home from my scrap iron business about six, sometimes seven and sometimes eight and often as late as nine o'clock. I was out practically every day in the scrap business, collecting scrap iron. The day that Mr. Rodrigues asked me to go and get the sugar, I was home because I only had a short haul to make and I had been sorting scrap from early in the morning. Mr. Rodrigues asked me to go for the sugar about

(Testimony of Leslie A. Woodworth.)

seven o'clock in the morning. He just asked me if I would go and pick up some sacks for him as his car had broken down. I went to the Independent Market in Watsonville to get the sacks and I saw that they said "sugar" on them, but I didn't say anything about it. When I went to get the sacks I saw that they said "sugar" on them, but at the time Rodrigues asked me to go, he did not tell me what kind of sacks they were. When I got there, Mr. Goon pointed them out to me and they were stacked up in the back of the room and I took them. At the time that Rodrigues asked me to go for the sacks because his car was broken down, I did not know where his car was and I don't know how he got over to the ranch, whether he walked or he got a ride with somebody. When I returned with the sacks of sugar and left them in my car, Mr. Rodrigues, I assume, took them and drove them away, though I did not see him do it. If at the last trial of this case I said that at the time that we leased the barn to this man was in April, then that was correct and my present testimony that he leased it in June would be incorrect. If the testimony at the last trial showed that I said that I saw the man who rented the barn once, that would be correct, and my present testimony in that regard would be incorrect. If I testified [48] at the last trial that I did not look into the barn, that testimony would be correct and the testimony I am now giving would be incorrect. If I testified at the last trial

(Testimony of Leslie A. Woodworth.)

that Mr. Rodrigues took care of the pigs and that I did not, that testimony would be correct, and my testimony in this trial incorrect. If I said at the last trial that Mr. Rodrigues did not come to the ranch after the hog-raising deal fell through except to pay me social calls, that testimony would be correct and my testimony in this trial that he was working in the barn after the barn was rented would be incorrect. When I noticed the increase in my electric bill I talked to Mr. Rodrigues about it and he said that whatever the extra amount was, that he would pay the money for it. I did not at that time ask him what he was using the pump for. Mr. Rodrigues at that time was not doing any farming.

When I was in the scrap iron business I would sell my scrap iron to Levin Brothers and also Markowitz and Fox in San Jose. Levin Brothers are located on the "101" highway just outside of San Jose, and Markowitz and Fox are in San Jose about half a block off Santa Clara. I did not sell all of my scrap iron to Levin Brothers, I was selling to both Levin Brothers and Markowitz and Fox and also to Barnard and Levin and at times I used to take some of it up to Niles. I may have sold scrap to Levin Brothers in January and also in February and also in March and May. I may have sold scrap to them in July and also in June, I would not be certain as to the month of August. I made sales of scrap about once or twice a week, it all de-

(Testimony of Leslie A. Woodworth.)

pended on the amount and kind of scrap I had. Sometimes I had more metal than I would have iron and other times I would have more iron than metal and different companies would pay different prices on metals, some would pay two or three cents higher and some would pay two or three cents lower. At the time I heard the explosion I did not know [49] at that time what a still was. Tony Rodrigues explained to me what it was. He just said that he had trouble with the still and that it had blown up. I asked him what he was doing, and he said that he was just working there. I had heard about stills before that and when he mentioned the word "still" I knew what it meant, yes. I did not at that time report to the officers that there was a still upon the premises. When I talked to Mr. Boch about getting the garbage at Camp McQuaide I did not know how much garbage there would be. When I talked to Mr. Boch about the garbage at Camp McQuaide I did not know when the soldiers would be there nor did I know how many would be there. Mr. Boch did not tell me that soldiers would be there only once or twice a year. I did not ask Mr. Boch how many troops were there, nor how much garbage there would be there. The only thing I knew is that sometimes there would be more garbage than at other times.

Redirect Examination

It was my original intention to get six brood sows and a male hog.

(Testimony of Leslie A. Woodworth.)

When I testified at the last trial and after I told Mr. Rodrigues that the garbage deal fell through and he told me he would have to go out and get a tractor job, he at that time lived with his mother and sister in Watsonville. When I so testified, I was referring to the time prior to the time when the barn was rented, when I said at the last trial he came back to the place three or four times, I meant prior to the time that the barn was rented. Prior to the time the barn was rented, the only work Mr. Rodrigues did was when he was working on the house with me. The two pigs that I bought, I bought quite awhile before I knew that I could not get the garbage from Camp McQuaide. When I testified at the former trial that Mr. Rodrigues [50] took care of the pigs, I meant that he took care of the pigs after the barn was rented and that before the barn was rented, my wife and I took care of the pigs. When I testified at the former trial that I had never looked in the barn, what I meant to say was that I had never actually been inside the barn; prior to August 28, 1941, I had not seen the still on these premises or had I seen a still on any other premises. I don't believe that I understood what Tony meant when he said the still had broken down. However, I know what a still is from reading about it. I am thirty-four years of age and do remember the National Prohibition Act and I have heard of persons being elected for bootlegging. I did not know whether

(Testimony of Leslie A. Woodworth.)

it was legal or illegal to have a still. I had heard about people being arrested for running illicit stills and I heard about people being sent to jail for that. Then I thought that Tony had been running an illegal still after he had told me that the still had blown up. The wind on the Hall Ranch blows from the west always towards the east or towards the northeast.

I remember having one conversation with Mr. Hall about the Hall Ranch, and that conversation was sometime in June. We were talking about ranching and he wanted to know if I was going to do any farming there and I told him I wasn't financially fixed to do any farming at that time and I told him that I had intended to raise hogs but that the contract at Camp McQuaide had fallen through and I was unable to get any feed for the hogs from that source and that I would have to let the hogs go for the time being and he at that time said, couldn't you raise feed somewhere near here and I told him that it took money to raise feed and I didn't have the money to do so at that time.

Recross Examination

I remember seeing Mr. Hall upon the ranch upon one occasion [51] and that was in the evening.

Examination by the Court

I had two horses and I kept them in the small barn near the lake. Sometimes I took care of them

(Testimony of Leslie A. Woodworth.)

and sometimes my wife did and sometimes the girl did. There is a large lake near the barn where the horses were. I would say it would be half to three-quarters of a mile long and about three hundred yards wide and the water would be about fifteen or twenty feet deep. The barn where the horses were was practically right on the left of the lake. It was built up level. I did not see any running refuse from the still into the lake until after I was arrested and released. I understand that the Hall Ranch comprises about twenty acres. I would say that the lake itself occupies about an acre and a half on the small lake and two acres on the large lake. There are two lakes on the property. I bought the pigs but I did not go into the barn. I did not know that pigs stayed in the barn, they stayed out in the corral alongside the barn. The man that I testified to that I saw there at the barn after it was leased was to the best of my knowledge not too tall a man, rather thin-built, I would say a medium complexion, not dark and not light. To the best of my knowledge I would say he was a foreigner of some type. I do not know who he was and I did not inquire. I did not think it was any of my business to inquire who he was other than that Mr. Rodrigues had the dealings with him and he had rented the barn to him. I knew that Rodrigues told me he was getting \$20.00 a month and I was very much satisfied with that amount of rent from the barn, because I had no

(Testimony of Leslie A. Woodworth.)

means of making sufficient money to pay the rent and after all, we had built the house and I didn't have no money to go out and rent another house and I was satisfied to have a place in and go about my business. [52] I do not know whether the rent from the barn was ever paid but I do know that I did not get any of it. I did not go into the tank-house. I saw the tank-house on the outside but did not go in it. The house that I built was a small house, it had a bedroom, a kitchen and a dining room place. It was a small house. It was built of lumber and it cost about \$135.00 to \$150.00. I did not go into the tank-house to see whether it was a place that we could live. I wasn't interested in living in a tank-house or in the barn. The sugar that I got I should imagine weighed about a hundred pounds a sack. I did not ask Mr. Rodrigues what he wanted with four hundred pounds of sugar. I did not store any of my scrap iron in the barn. After Rodrigues told me about the still, I was not interested in going to see it, though I did think that the still might cause us trouble. After he told me that there was nothing to worry about, that I was only living on the place and that he was only working there and he told me that there was nothing to worry about if I didn't do anything more.

Testimony of
EUGENE E. GLORR

Eugene E. Glorr, produced as a witness on behalf of the defendant Jehl having been first duly sworn, testified substantially as follows:

My name is Eugene E. Glorr and I am a physician and surgeon practicing my profession in Watsonville, California and have been practicing there since 1940. I know the defendant Raymond Jehl and have known him since the latter part of 1934 and he has been a patient of mine during that period of time. During the period of time from the latter part of 1939 to the early part of 1940 Mr. Jehl was under my care and during that period of time I advised him to seek a warmer [53] climate than the climate in Watsonville. I also advised to seek a change of activity. I did not learn until later that he had gone into the restaurant or saloon business in San Jose. I would not necessarily have advised him to have done this.

Cross Examination

Mr. Jehl was being treated by me because of loss of weight, being nervous and he had a persistent cough, and the moist air of the coast is not beneficial to that type of cough and I, therefore, advised him to seek a warmer climate. I would not necessarily say that night club business would be good for his nerves or for the type of cough he had but sometimes you give patients advice, that they do not necessarily follow.

Testimony of

CLYDE H. HINES

Clyde H. Hines, a witness called on behalf of the defendant Woodworth, being first duly sworn, testified substantially as follows:

My name is Clyde H. Hines and I reside in Watsonville, California and I am a service station operator and have been such for about six years. I know the defendant Woodworth and have known him for about four years. He buys products from me, that is gasoline and oil for his truck and he was buying these commodities from me during the year 1940. He would come into my station with a V-type Ford truck and also a coupe. When I would see the truck it would be loaded with scrap iron and I knew that he was in the junk or scrap iron business. He would come into my place about three times a week with his truck, quite often with his wife and stepdaughter accompanied him.

Cross Examination

I did not know that Woodworth was operating a hog ranch outside of Salinas nor did I know that a still was found on the ranch where he was operating the hog ranch. He has been a customer of [54] mine off and on for four years. He was in quite often during the year 1940. I would not say that he had been a constant customer of mine during the last four years.

(Testimony of Clyde H. Hines.)

Redirect Examination

Since January, 1940 until September, 1940 he was a pretty regular customer. Pretty near every week he would come into my place.

Recross Examination

From May to September I would say that he came into my place with both his Ford coupe and truck. He would average about three times a week depending upon business and how he picked up his scrap iron. Every time he would come in with the truck I would see scrap iron on it. I would see his wife and step-daughter on several occasions when they came in both in the truck and in the Ford coupe.

Testimony of

ANGELO GORDON AMIZICH

Angelo Gordon Amizich, produced as a witness on behalf of the defendant Jehl, being first duly sworn, testified substantially as follows:

My name is Angelo Gordon Amizich and I am at the present time a soldier stationed at Fort Ord, California. I was inducted into the service under the Selective Training Act and I have been stationed at Fort Ord exactly two months and fifteen days. From the month of June 1940 till the month of September, 1940 I was employed at the Colonial Inn just a little southwest of San Jose on the high-

(Testimony of Angelo Gordon Amizich.)

way. The Colonial Inn was a night club and restaurant that serves meals. I was employed there in the capacity of manager and I also tended bar. I was employed by Mr. Jehl, the defendant in this case. While I was employed there, there was a young lady also employed there by the name of Mrs. Carrillo. When I first knew her, her name was Della Rowe and [55] she later became Mrs. Carrillo. She was the wife of Joe Carrillo. She was employed at the Colonial Inn as a waitress and her husband also was employed there for part of the time in the capacity of musician. It is not true that during the latter part of August or the first part of September of 1940 that I was present on an occasion when Mr. Jehl was present, Mrs. Carrillo and Mr. Carrillo at the Colonial Inn, during which time a conversation took place in which Mr. Jehl said to Mrs. Carrillo in my presence and in the presence of Mr. Carrillo and Mrs. Carrillo that he was down in the dumps because he had to go to San Francisco to bail out some men in connection with a still. No conversation ever took place in my presence. It is not true that about the same time there was another conversation in which Mrs. Carrillo was present and myself and Mr. Jehl in which Mr. Jehl said in substance that *he* I would have to take care of the place because things were getting too hot for him and that he had to go to Reno for a couple of weeks. No such conversation ever took place in my presence. During the time that I was

(Testimony of Angelo Gordon Amizich.)

employed there, I lived on the premises and my sister also lived there. She was a student at San Jose State Teacher's College. Mr. Jehl lived there at times too. On some occasions he would go to his home in Watsonville. On occasions he would be away for one or two days, nor more than two days at any time. When he was away, I was in charge of the place. We bought our liquor that was used at the Colonial Inn from Koerber in San Jose. At no time while I was on the premises of the Colonial Inn was any liquor used that was not tax-paid. On two occasions while I was there the State Board of Equalization authorities came to examine the stock and look over the stock. [56]

Cross Examination

I did not at any time have any conversation with the Federal officer at the Colonial Inn in connection with Mr. Jehl. However, a Federal officer did come to see me at Camp McQuaide while I was working there. I believe that he came to see me either in November or the latter part of December of 1940. I do *not whether* a federal officer ever came to the Colonial Inn and talked to Mrs. Carrillo. I generally work the shift from eight o'clock in the morning until two o'clock at night. My duties were to tend bar and to see that the customers were waited upon. On occasions when there would be conversations between Mr. Jehl and Mrs. Carrillo and myself, sometimes I would have to leave the

(Testimony of Angelo Gordon Amizieh.)

conversation to wait on a customer. I was not at the Colonial Inn on an occasion when Mr. Jehl and Mr. Woodworth and Mr. Rodrigues came there. I have not been in the Colonial Inn except once since I left there in December. It could be possible that there was a conversation between Mr. Jehl and Mrs. Carrillo at which I was not present and did not hear.

Redirect Examination

I did not hear such conversations as you have related to me and such conversations did not take place in my presence. There were occasions when Mr. Jehl would leave the place, he would either go home or he would tell me he was going to San Francisco, and when he was gone I would take charge of the place.

Testimony of

RAYMOND HOWARD JEHL

Raymond Howard Jehl, one of the defendants, produced as a witness on his own behalf, having been first duly sworn, testified substantially as follows:

My name is Raymond Howard Jehl. I am a man of family. My family consists of my wife and my daughter and my wife's mother. [57] I reside in Watsonville, California and have resided there for about thirty years. I have lived continuously in

(Testimony of Raymond Howard Jehl.)

Watsonville during that period of time except when I was overseas during the last war. I was born in Tennessee. I am a real estate broker and insurance broker, licensed under the law of the State of California by the Real Estate Commissioner of the State of California. I have been so licensed since 1913 or 1914 and during that period of time I have been engaged as a licensed real estate broker in Watsonville, California. I am in business there with my brother Sidney A. Jehl. My place of business located at 302 Main Street in the Fox Theater Building.

The photograph that you show me represents my place of business in Watsonville.

Whereupon the photograph was offered in evidence as an exhibit on behalf of the defendant Jehl and marked "Defendant's Exhibit A".

During the period of time from January 1940 to September 1940 my brother and I were the agents for a subdivision in and around Watsonville and one of these particular subdivisions was owned by a Dr. Cutter. From the latter part of 1939 until the early part of 1940 I was under the care of Dr. Gloor. During that period of time Dr. Gloor advised me to seek a change of climate and he also advised me to seek a different type of business if I could. I went into the possession of the Colonial Inn. I believe the first week in June of 1940 and I continued in possession until September of the same year. During that period of time I lived part of

(Testimony of Raymond Howard Jehl.)

the time at the Colonial Inn and part of the time at my home in Watsonville, California. While I was in possession of the Colonial Inn, my manager was Angelo Amizich. Mrs. Carrillo was also employed there and Mr. Joe Carrillo, her husband, [58] was employed there for a time.

I know the witness Earl Goon, who testified here. I have known him for several years around Watsonville and I knew his father very well. I had occasion to do business with his father. During the month of April, 1940 I had occasion to go to the Independent Grocery Store in Watsonville. I went there with a Mr. Giorodoni. Sometime during the month of either the latter part of April or the first of May, 1940 this Mr. Giorodoni came to my place of business in Watsonville and asked for me, and at that time I had a conversation with him. He presented a card for me from a Louis Hirsh, a *jewelry* who had a store in San Jose and one in Salinas. I have known Mr. Hirsh for about twenty years. Back of the card that this Mr. Giorodoni presented to me was my name and address. At that time this Mr. Giorodoni told me that he would like to have some information about the town. He also asked me if I knew the Independent Grocer and I told him that I did. He thereupon asked if I would introduce him to them and I said that I would. We went to the Independent Grocery Store and we met Earl Chin whom is also known as Earl Goon. He is the gentleman who testified in this trial. At that time

(Testimony of Raymond Howard Jehl.)

there was a general conversation about the different things, commodities and among them was sugar. There was conversation about a price for sugar and also about an amount of sugar, about how much sugar he could get. At that conversation, there was no order placed with Mr. Goon for any sugar. Giorodoni and I then left the Independent Grocers and went back to my office. Giorodoni then thanked me for my courtesy and left me and said he would see me again. The next time I saw Mr. Giorodoni was at the Colonial Inn in San Jose and I believe that sometime, about the first week or the latter part of June, 1940. [59] At the time I first met Mr. Giorodoni in Watsonville, I told him that I was thinking of taking over the Colonial Inn in San Jose. Mr. Giorodoni came to the Colonial Inn on several occasions, sometimes he was alone and sometimes he would have other people with him, and quite often he and his party would stay for dinner.

On one occasion when Giorodoni came into the Colonial Inn, he asked me if I would do a favor for him, and I told him that I would. He asked me if I would take some money for him to the Independent Grocery in Watsonville. At that time I was going back and forth to Watsonville at intervals. At that time he gave me \$45.00 or \$50.00. I went to Watsonville that night. The following morning I went to the Independent Grocers there I saw Earl Chin and I gave him the money. I told him

(Testimony of Raymond Howard Jehl.)

Mr. Giorodoni had left this money with me for me to give to Mr. Chin and that Mr. Giorodoni had said for Mr. Chin to set aside some sugar and that he, Mr. Giorodoni, would have someone come in later and get it. That was all the conversation at that time. Sometime after that Mr. Giorodoni asked me again if I would take some money to Mr. Goon's grocery store, which I did. I believe that I did this on three occasions. At the time I had these conversations with Mr. Giorodoni and when I took the money to Mr. Goon for the sugar, I did not know what the sugar was to be used for and I did not know that it was to be used in connection with an illicit distillery. I learned for the first time in the latter part of August or the first part of September that this sugar had been used in an illicit distillery. One of the men who used to come into the Colonial Inn with Mr. Giorodoni came in one day and asked me if I knew that Mr. Giorodoni's still had been seized or knocked over. At first I thought he was joking, and I told him that I did not think [60] that Giorodoni was in that kind of business. He then asked me if anybody had questioned me and I asked him why. He then asked me if anybody had questioned me and I asked him why and he told me that I had taken some money to buy some sugar and that is the first time that I knew that the sugar that I had purchased was used in an illicit still. When I found that out I got in touch with Mr. Goon, that is Mr. Harry Goon, who is a brother

(Testimony of Raymond Howard Jehl.)
of Earl Goon. I tried to explain to him that the sugar that I purchased from him had been used in an illicit still and I told him not to give any more sugar to Giorodoni. After that I went to see Mr. Earl Goon and I did have a conversation with him in Watsonville. I told him what I had learned about Mr. Giorodoni and he told me that he had read about it in the newspapers. I later saw Mr. Earl Goon in Watsonville and he told me that he had been interviewed by the Government agents. I did not ask him to hold any information from the Government officers concerning my activity in connection with the purchase of the sugar.

I heard Mrs. Carrillo testify that in the early part of August or the first part of September, 1940, that I had a conversation with her at which were present her husband, Mr. Amizich and myself in which I am alleged to have told her that I was down in the dumps because of the fact that I had just come from San Francisco where I had bailed out some of my men in connection with a still. No such conversation ever took place, nor did I ever mention a still or bailing any men out to Mrs. Carrillo, nor did I at any time in my life bail anybody out. I know Mr. Rodrigues, I have known him around Watsonville for several years but I did not know him intimately. I knew his mother and brother. I did not at any time have any activity with Mr. Rodrigues in connection with this still or any other still. [61] The other defendant, Mr. Woodworth, I

(Testimony of Raymond Howard Jehl.)

met for the first time in Mr. Abrams' office. Mr. Abrams is my attorney and that was after I was indicted in connection with this case. I also heard Mr. Carrillo testify to this alleged conversation at which were present he, myself Mrs. Carrillo and Amizich. No such conversation as he testified to ever took place. I heard Mrs. Carrillo testify that sometime in the first part of August in the kitchen of the Colonial Inn that I had a conversation with her at which she and I alone were present in which I am supposed to have told her that it was awful to stand on a hill and see so many thousands of dollars going to waste. I never at any time had such a conversation with Mrs. Carrillo. I also heard Mrs. Carrillo testify that while I was negotiating with Mrs. Kaiser for the purchase of the Colonial Inn that I told Mrs. Kaiser at which time Mrs. Carrillo is alleged to have been present, that Mrs. Kaiser did not have to worry about her rent, that I was only going to use this place as a stopping off place. I did not at any time tell Mrs. Kaiser in the presence of Mrs. Carrillo that I merely wanted to use the Colonial Inn for a stopping place and that she did not have to worry about her rent. Mrs. Kaiser owned the Colonial Inn part of the time that I went there and I leased the place from Mrs. Kaiser. I withdrew from the Colonial Inn in September of 1940 as a result of a law suit which was filed against me by the Kaisers. That lawsuit was subsequently settled and the Kaisers were back in

(Testimony of Raymond Howard Jehl.)

possession of the Colonial Inn and as far as I know, they are still running the place. I also heard Mrs. Carrillo testify that in the latter part of August, 1940 that I told Mr. Amizich, the bartender, in her presence to look after the place, or words to that effect, because things were getting hot for me and I had to go to Reno for a few days. No such [62] conversation ever took place, nor did I go to Reno at or around that time. I heard Mrs. Carrillo testify that sometime prior to the last trial of this case which commenced on June 12th that I in company with Mr. Woodworth and Mr. Rodrigues went to the Colonial Inn, that Mr. Woodworth and Mr. Rodrigues entered the inn and that I had a conversation with Mrs. Carrillo in my car in which I told her, after she had told me she had been interviewed by the Government officers, "Remember, you don't know nothing". I did go to the Colonial Inn with Mr. Woodworth and Mr. Rodrigues at about that time and I did have a conversation with Mrs. Carrillo. I told her that my attorney had advised me to stop by on my way home and see whether she had been called as a Government witness because he understood she was called and I did not know what she knew about the case, it was a puzzle to me, and my attorney wanted to know what she could be called as a witness for. She told me at that time that some officers had been to see her but she didn't know anything. Prior to going to see Mrs. Carrillo, on this occasion, I had been in my attorney's office,

(Testimony of Raymond Howard Jehl.)

Mr. Abrams. At that time Mr. Gould, the attorney, was also there, and Mr. Woodworth and Mr. Rodrigues. That was a few days prior to the last trial while we were getting ready for trial. Mr. Abrams asked me what Mrs. Carrillo could know about the case and I told him that I didn't know anything that she could know regarding the case. On the occasion that I went to Mr. Abrams' office I had come from Watsonville alone. When I got to Mr. Abrams' office Mr. Woodworth and Mr. Rodrigues were there. Mr. Gould asked me if I would drive him home and I said that I would and I drove him back to Watsonville.

Cross Examination

At the time to which I refer, Mr. Abrams was my attorney [63] and Mr. Gould was Mr. Woodworth's attorney. Mr. Gould and Mr. Abrams have offices in the same building. I don't know whether they have the same offices or not, we all met in Mr. Abrams' office. I do not know who Mr. Rodrigues' attorney was, but Mr. Rodrigues was there consulting his attorney also. I do not know whether Mr. Rodrigues was represented by Mr. Abrams or by Mr. Gould, but he was there as a client of either one of them.

I moved over to San Jose because of ill health and because I thought it would be beneficial to my health. I did not take my wife and daughter with me because they were living at my home in Watson-

(Testimony of Raymond Howard Jehl.)

ville. I went by myself to San Jose until such time as I could become established. I had a business established in Watsonville and after I could regain my health, I wanted to stay in Watsonville. If I could become equally established in San Jose, naturally being better for my health, I would stay there permanently. I went to San Jose in May of 1940 and went into the night club business and I stayed there until September 1940. In September 1940 I would have liked to stay in San Jose but business was not so good. If I could be established permanently in San Jose as I was in Watsonville, I would have stayed in San Jose, but I went into the night club business in San Jose, I was also in the real estate business in Watsonville. At that time we were agents for a subdivision being built just outside of Watsonville, and I was partially active in that.

This Mr. Giorodoni first came to see me in the early part of May of 1940. I believe it was in the early afternoon and he came to my office in Watsonville. He first asked for Raymond Jehl and I walked up to the counter and he handed me a card of Louis Hirsh, the jeweler, with my name and address on the back of it. [64] Mr. Hirsh has a jewelry store in San Jose and one in Salinas. I do not know which one of the stores the card was sent from. I have not the card that was presented to me by Mr. Giorodoni nor have I looked for it, nor do I know where it is. My name and address

(Testimony of Raymond Howard Jehl.)

was on the card. Mr. Giorodoni and myself talked about different things and different merchants in the town. He particularly asked me if I knew the Independent Grocers and if I knew the owners and I told him that I did. He then asked me if I would introduce him to the owners of the Independent Grocery and show him where they were. I then took him over to the Independent Grocers and there I saw Earl Chin whom I now know as Earl Goon. I introduced Mr. Giorodoni to Mr. Chinn. I do not remember the exact words that took place on that occasion. I presume that I could have said something about Mr. Giorodoni being a prospective customer. Mr. Giorodoni had not told me that he wanted to purchase anything prior to that time, he merely wanted me to introduce him and to show him where the place was. Mr. Giorodoni and Mr. Goon discussed things and I heard them talk about the price of sugar and the amount. I was just a spectator there. At that time I thought I was doing a favor for Mr. Hirsh as well as for Mr. Giorodoni. The next time I saw Mr. Giorodoni was at the Colonial Inn in San Jose. That would be about two weeks after I first introduced him to Mr. Goon. At that time I was in the restaurant and cafe business and we had liquor and sold liquor upon the premises. Sometimes we had a three-piece orchestra and sometimes we did not have any music. Sometimes Giorodoni came to the Colonial Inn with one person and sometimes alone and sometimes he would

(Testimony of Raymond Howard Jehl.)

have three or four in his party. I believe he came in one or two times before he asked and spoke to me about the sugar and in those occasions there was just general conversation. One night when [65] he was there he came over and asked me if I would do a favor by taking some money to Watsonville, for him to the Independent Grocers. He told me to tell them to set aside or put aside, or hold, something like that, some sugar, and that he would have someone pick it up later. He did not say who he would have to pick it up. He may have told me to give the money to Mr. Chinn and hold out that much sugar. My best recollection is that he asked me if I would take the money to the Independent Grocers. After this first occasion when he asked me to take money to the Independent Grocers I believe that he came into the place quite often. I am not certain on the second occasion when he asked me to take money to the Independent Grocers, it may have been a week, it may have been the following day. I don't know just exactly when it was. My best recollection is that it was approximately two weeks after the first time when he asked me to take the money down for sugar that he spoke to me about it again and that he then asked me if I would take some money down to the Independent Grocers and I told him that I would and he gave me the money. I did not go to Mr. Goon's the same night but I went there with the money two or three days later. Before going down on this second occasion

(Testimony of Raymond Howard Jehl.)

I phoned Mr. Goon. I had told Mr. Giorodoni that I was going down that night but later I found that I couldn't go that night because I wasn't feeling well and I did not want to inconvenience Mr. Giorodoni so I phoned Mr. Goon and told him that Mr. Giorodoni had left some money with me for him. I think it was \$45.00. I also told him to let the man have whatever Mr. Giorodoni had ordered and the first time I was in Watsonville I would give him the money. I presume it was sugar that he had ordered the same as before. I do not recall exactly when the third occasion was that I ordered the sugar or paid for the sugar. I really didn't think I was ordering it. Later a man came into [66] the Colonial Inn whom I had seen with Mr. Giorodoni and he asked me if I knew about Mr. Giorodoni losing his still. The man that came in I knew by sight. He was short, sort of dark-complected with a heavy head of hair and I would say he was around thirty-six or thirty-eight years of age and may have been either an Italian or a Slovenian. Mr. Giorodoni was a larger man, much taller, and I should judge to be a man of around one hundred ninety or one hundred ninety-five pounds. He was either Italian or Slovenian, too. When this man told me about Mr. Giorodoni's still having been knocked over, I told him he did not appear to me to be in that type of business and that I thought it was a joke. He then asked me if anybody had been in to

(Testimony of Raymond Howard Jehl.)

question me and I asked him why anyone should question me and he said, well, that I had been taking money down to the store in Watsonville that was used to buy sugar. I first asked him how he knew that and he told me that Mr. Giorodoni had told him. I knew that I was ordering sugar from Mr. Goon. It is not true that I ordered sugar six or seven times. I never took money down there more than three times. After I heard the still had been knocked over, I did telephone Mr. Goon to tell him what I had heard. When this party told me about the still and my carrying money down there and it being used for ordering sugar I was worried. I phoned to Mr. Goon to tell him I had introduced this man to Mr. Goon and if I was getting Mr. Goon into trouble I wanted to stop him. At the same time I was worried myself and I did not want to get Mr. Goon into any deeper trouble. The first time I told Mr. Goon to set aside sugar for Mr. Giorodoni. The second time I did not know what it was for but I told Mr. Goon that I had \$45.00 that Mr. Giorodoni had told me to give him. I don't remember about the third time, but it seems to me that I did go down there three times, but I don't recall. [67] I don't quite recall it but I think that I did. The telephone call that I have testified to was in regard to the second occasion when I went down because I could not go down that night and I didn't want to inconvenience either Mr. Giorodoni or Mr. Goon and it was probably two or three days

(Testimony of Raymond Howard Jehl.)

later that I took the money down to Mr. Good. I really couldn't tell you what business I thought Mr. Giorodoni was in but the type of man that he was, he did not appear to be a man that would be monkeying around with something like that. He didn't tell me what line of business he was in. I formed the opinion that it would be in a pretty fair line of business and he did not tell me what he was ordering the sugar for. The first time that I knew anything about a still was when this man came in and told me about Mr. Giorodoni losing the still and that conversation took place in the Colonial Inn. At the time that this conversation took place, Mrs. Carrillo was in the Colonial Inn and the bartender was there. The occasion when this man came in was sometime in the latter part of August or the first part of September. At that time the bartender was present on the premises and so was Mr. Carrillo. She was on duty, I don't know whether or where she was but whether she was right there or around me or not. I got out of the night club business either in September or in October of 1940. After this short man came in to see me I went down to see Mr. Goon because I could not reach him on the phone and I was worried about it myself and I was worried if I had caused him any trouble by having introduced this man to him. I was worrying about his continuing in the same way when I found out that something was wrong, that it was the wrong kind of business for him to be

(Testimony of Raymond Howard Jehl.)

doing, and I wanted to let him know and stop him. I was worried about myself and [68] I was worried about Mr. Goon and thought the best thing to do was to try to stop him. I did not want to get mixed up in a thing like that and I did not want this man I introduced him to to become mixed up in it either. I was worried when this man told me that I had been ordering sugar because I had asked him what the sugar was for and he told me that is what they made the liquor out of and at that time I thought the sugar was used in the operation of a still.

In response to your Honor's question I would say that it was about the middle of August that I last saw Mr. Giorodoni. He had come into my place on several times. There were women in the party, sir, when they came in there. I do not know where he lives and I never asked him his business, nor do I know where he lives now and I do not know where he is now. I have endeavored to find out where he is.

Whereupon the defendants rested.

Whereupon the defendant, Jehl, moved the court for a directed verdict of not guilty and renewed the motion made at the conclusion of the Government's case in chief, which motion for a directed verdict was by the court denied, to the denial of which the defendant then and there duly and regularly excepted.

Rebuttal Testimony by the Government

Testimony of

DAVID LEVIN

David Levin, a witness called by the United States in rebuttal, being first duly sworn, testified substantially as follows:

My name is David Levin and I operate a business of salvaging and buying scrap iron and so forth in San Jose and I was in that business during the year 1940. I know the defendant Lester Woodworth [69] and I did business with him in the scrap iron business. I identify him as being the defendant on trial. I did do business with him during the year 1940. I have brought with me check stubs showing the payments that I made to Mr. Woodworth for scrap iron during the year 1940. They are all my checks and represent moneys that I have paid to Mr. Woodworth by check for scrap iron during 1940.

At which time the checks were offered in evidence and marked U. S. Exhibit 11.

Whereupon, by stipulation, the dates, amounts and names of the checks were read into evidence and they are substantially as follows:

Pay to the order of L. A. Woodworth, \$35.00, San Jose, California, 2/10/40.

Pay to the order of L. A. Woodworth, \$25.00, San Jose, California, 1/27/40.

Pay to the order of L. A. Woodworth, \$19.79, San Jose, California, January 30, 1940.

(Testimony of David Levin.)

Pay to the order of L. A. Woodworth, \$22.00, San Jose, California, 2/16/40.

Pay to the order of L. A. Woodworth, \$26.27, San Jose, California, 2/23/40.

Pay to the order of L. A. Woodworth, \$32.40, San Jose, California, 9/23/40.

Pay to the order of L. A. Woodworth, \$16.58, San Jose, California, September 26, 1940.

Pay to the order of L. A. Woodworth, \$18.00.

I do not remember seeing the defendant Woodworth during the months of May, June, July or August or the latter part of September, [70] 1940. Of course, there are times when I am not there. I have a partner in the business and he does the buying when I am out. I cannot definitely recall whether I saw him during the period of time you mention or not.

Cross Examination

I was not always present when Mr. Woodworth brought scrap iron to our place of business. On some occasions my brother was there and some of the checks are signed by him. We did not always pay Mr. Woodworth by cash. I would say that these checks represent about fifty percent of the purchases and the rest of them would have been by cash. It is possible that he was paid for some payments by cash. I notice that two of the checks are dated September 23rd and September 26th. It is possible that he could have been paid by cash dur-

(Testimony of David Levin.)

ing that period of time. I have no definite recollection on it. It is also possible that during the months of May to August, he may have been paid by cash, though I have no checks showing any payments and I cannot say definitely that he was not paid by cash during that period of time. I also know that during that period of time Mr. Woodworth was selling scrap to other dealers in and around San Jose.

Testimony of

CHARLES J. HEALEY

Charles J. Healey, a witness called by the Government in rebuttal, by the Government first duly sworn, testified substantially as follows:

My name is Charles J. Healey and I am a Captain, Quartermaster Corps, United States Army and I am now stationed at Camp McQuaide, near Watsonville, California, and I hold the official [71] position as Post Quartermaster. Camp McQuaide was a National Guard encampment place. During the month of January, 1940, the 250th Coast Artillery of the California National Guard was stationed at Camp McQuaide. They were stationed there for a period of one week in what we call a winter camp and winter training. During the months of February, March, April, May and June of 1940 there were no troops stationed at Camp McQuaide. During the last two weeks of July, 1940

(Testimony of Charles J. Healey.)

and the first week of August, 1940, the 250th Coast Artillery was stationed there. On September 15th, 1940 that regiment was called into active service and was then stationed at Camp McQuaide. I did not know in April, May or June of 1940 that the National Guard would be called out in September 1940. A camp tender would not have authority to enter into a contract for the disposal of garbage, nor would a sergeant have such authority. It would have to be done by the Post Quartermaster, that is either by the Post Quartermaster or by one of his designated commissioned assistants. The camp tender would not necessarily be asked to make an investigation or to make contact with possible persons that might be interested in the disposal of the garbage. The camp tender would not on any occasion that I know of ever take the matter up with his superior officer, making suggestions in that regard. Contacts would generally be made from the office by a bidders' list. That is according to the army regulations and practice to put the garbage out to the highest bidder on a contract basis and that is true as long as I have been Quartermaster at Camp McQuaide, that is, since November, 1940. I know that the army regulations so provide and I have no personal knowledge of [72] what took place at Camp McQuaide before I went there. I do not know how it was handled in 1939. I have no way of knowing whether or not part of November, 1940, garbage was given away to a person without any

(Testimony of Charles J. Healey.)

compensation being paid to the Government. I have never known of such an instance. I did not know Mr. Boch when he was at Camp McQuaide in January, February, March and April of 1940. The Post Quartermaster signs the contract for the final disposal of the garbage. In May of 1940 I was stationed in Los Angeles. There are possibly three or four national guard camps in California. It has been customary during the past two or three years for the 250th Coast Artillery, which was the San Francisco National Guard regiment to have their summer training at Camp McQuaide. In 1940 it was held in July, the last two weeks in July and the first week in August.

Redirect Examination

Up until the time of the emergency, the National Guard was only called out once a year for a period of two weeks, with the exception of the year 1940 when they were called for one week more.

Recross Examination

I do not know of any specific instance when these camps would be used by the regular army for stopping over places or what they call bivouac or one or two night stands. It could be possible. I do not know of my own knowledge, that in the early part of 1940 that such was the case with regard to the regular army in Camp McQuaide. If Mr. Bock so testified, I would not say that it was incorrect.

(Testimony of Charles J. Healey.)

Further Direct Examination

In other words, it is possible that they could have been [73] there for a one-night stand. When a military organization is on the march, if they have to bivouac for the night, naturally they like to pick an army post rather than rent private land and pay compensation for it.

Testimony of

CLAY GAINES

Clay Gaines, a witness recalled in rebuttal by the Government, testified substantially as follows:

Direct Examination

Sugar is a very essential element in distilling alcohol.

Testimony of

LOUIS HIRSH

Louis Hirsh, a witness called by the United States in rebuttal, being first duly sworn, testified substantially as follows:

My name is Louis Hirsh and I reside in Salinas, California and I am in the jewelry business. I know the defendant Raymond Jehl and I would say that I have known him from twelve to fifteen years. I have been established in the jewelry store business since June of 1940 in Salinas. I do not know a

(Testimony of Clay Gaines.)

man by the name of Giorodoni. I did not during the month of April, May or June of 1940 give one of my business cards or a business card of Louis Hirsh, Jeweler, to a man by the name of Giodoni to be delivered to Mr. Raymond Jehl of Watsonville, California.

Some day last week I had a conversation with Mr. Jehl in my place of business in Salinas. Mr. Jehl wanted me to remember the fact that this particular person came in and that I had given him the card and as far as I know I don't remember any time doing anything like that. I told Mr. Jehl I did not know anything about it. He just wanted me to try and remember that case and to come up here and tell the court about it. I told him that I did not know anything of the [74] kind and that I would not do it. He asked me about it several times and let it go at that. I told him to do so would be telling an untruth and that I would not do that.

Cross Examination

I have known Mr. Jehl for about fifteen years and I have known him pretty well during that period of time. If anyone did come in and ask me about real estate business in Watsonville, I naturally would probably send them to him, but I don't remember sending any one. I imagine Mr. Jehl would send people to my jewelry store too. I know Mr. Jehl himself has been in the store and has bought from us. When Mr. Jehl came and

(Testimony of Clay Gaines.)

talked to me about it a few days ago, it is true that he asked me if I remembered having sent this man to him and I told him I did not remember anyone coming in for that. He seemed to be sure that it was a fact that I had sent this man to him and that the man had come in with a card from me, but I didn't remember anything about it. Mr. Jehl told me he was sure that I had sent a man with this card to him and I told him I could not remember it. One of the reasons that I did not want to come up here was that my father objected to my being a witness in the Federal Court and the other reason was that I did not remember any case like that coming up. I told Mr. Jehl that I could not get away from the store. I am **thirty-five** years of age. At that time I did not realize the importance of this thing. It didn't seem like anything at all at the time and Mr. Jehl asked me to come up here and tell the court that I sent a man over to him, and I didn't pay a great deal of attention to it at that time, but I didn't send anybody. It is true that Mr. Jehl told me that I had sent his man to him and I told him I did not remember it and he said, he remembered it because it would make me remember it. That is, he tried to refresh my recollection. [75] I told Mr. Jehl that I would get in touch with him at my father's jewelry store in San Jose last Sunday and let him know whether I would do anything, whether I would come up and testify and I did not keep that

(Testimony of Clay Gaines.)

appointment. I called up and broke it. Mr. Jehl did not tell me he wanted me to come up here to perjure myself. He told me he wanted me to come up and tell about this man.

Redirect Examination

When I told Mr. Jehl that I could not remember such a man, he still wanted me to come up here and testify.

Recross Examination

Mr. Jehl did not say anything about false testimony. He was insisting all the time that I had sent this man to him.

Further Redirect Examination

I told him that I would not testify to that effect unless I was positive.

Further Recross Examination

When I say I was not positive, it could have happened, but I don't remember any question like that coming up.

Testimony of

JOHN BECKER

John Becker, called as a witness by the United States in rebuttal, being first duly sworn, testified substantially as follows:

My name is John Becker and I am a Special

(Testimony of John Becker.)

Investigator of the Alcohol Tax Unit of the Bureau of Internal Revenue. Under the regulations of the Internal Revenue Department, it is not necessary for a person selling sugar to advise the Internal Revenue Department except when they have been previously notified by the Supervisor so to do. I made an examination of the records of the Internal Revenue Depart- [76] ment and I find that the Independent Grocery Store of Watsonville were not under obligation to notify the Department.

Surrebuttal on Behalf of Defendant

Testimony of

LESLIE A. WOODWORTH

Leslie A. Woodworth, one of the defendants, who had previously been sworn, was called as a witness in surrebuttal in his own behalf, and testified substantially as follows:

Between the months of August and March of 1941 I sold scrap iron to Levin Bros. I would say that I received payment for such scrap iron about one-third of the time by check, the other times by cash. I saw the witness Dave Levin on the stand here. I have done business with both he and his brother, Henry Levin. I believe I did more business with the brother Henry than I did with David. At the time that Mr. Bock told me that the deal for the garbage had fallen through, he told me that the reason for it was that the Army was going to ask

(Testimony of Leslie A. Woodworth.)

for sealed bids. The first conversation that I had with him about garbage in 1939, he told me that the Government at that time had to pay about \$250.00 a month for the removal of the garbage and I was willing to make arrangements whereby I would do it without compensation. When he told me that the deal had fallen through, he told me that the person who received the contract for the removal of the garbage was going to have to pay the Government for the removal of it.

Cross Examination

It is possible that on my direct examination when I told you that I could not remember whether I sold scrap iron to Levin Bro. in the month of May, 1940 and that the same answer was true of June, July and August, I do not have a full recollection that I sold [77] scrap iron to them during that full period of time. However, I sold it several different places and when I did sell, I sold most of it to Levin Brother that was not here this morning.

Testimony of

RAYMOND H. JEHL

Raymond H. Jehl, one of the defendants, who has previously been sworn, was called as a witness in his own behalf in surrebuttal, and testified substantially as follows:

I heard the testimony of Mr. Hirsh this morning. It is true that I went to see him and that I did

(Testimony of Raymond H. Jehl.)

have a conversation with him concerning the man that had been sent to me by him. After I had asked him about the man he had sent to me, he did not recall having sent him to me, and I was trying to recall it to him and I finally got it inveigled into his mind that he did send a man. He also admitted that he had sent other people to my office and he also told me at that time that his father objected to his coming to court to testify. I told him my attorneys were coming down to see him and made an appointment for him to meet them last Sunday. I did not tell Mr. Hirsh to come up here and testify falsely.

Cross Examination

Mr. Hirsh told me that he had sent men to my office on several occasions. I have known the Hirsh family for years. I knew his father over a period of fifteen years. There were many men that he sent to me. I do not know exactly, it could be hundreds. They would be friends and so forth. I know Al Hirsh. I talked to him on the phone last week. He did not at that time tell me to lay off his brother Louis. He did not tell me that Louis was not going to commit perjury for anybody. [78]

Testimony for the Government in Rejoinder

Testimony of

ALEX. B. HIRSH

Alex. B. Hirsh, a witness called by the Government in Rejoinder, being first duly sworn, testified substantially as follows:

My name is Alex B. Hirsh and I live in San Jose, California and I am in the jewelry business. I am a brother of Louis Hirsh who runs a jewelry business in San Jose. I know the defendant, Raymond Jehl and I have known him for many years, from twelve to fifteen years. I had occasion to talk to Mr. Jehl during the past week or so. It was on Sunday of last week. At that time I was in Big Sur. I recognized Mr. Jehl's voice over the telephone. I put a person to person call to him. At that time I told him not to try any longer to get in touch with my brother, because he was not going to have anything to do with the matter that Raymond wanted him to take care of, and Mr. Jehl then said to me, "I don't want to talk about it over the telephone", and the conversation ended. I told him that Louis was not going to commit perjury for anybody.

Cross Examination

Mr. Jehl did not ask me to commit perjury. I have known him for many years and he has had business relations with us and he has been a good customer and he has sent people to our store. I do not think that prior to the trial I had occasion

(Testimony of Alex B. Hirsh.)

to talk to Louise or whether or not he had sent any one to Mr. Jehl. Since Raymond has contacted my brother regarding this case, my brother has talked to me about it and he said he did not want to have anything to do with it, and naturally, I told him not to have anything to do with it. It seems my brother was told of a certain party or to tell of a certain party coming into the store and being sent to Raymond. [79] We discussed it and tried to think back and couldn't remember, didn't know anything about it. That is the only discussion we had regarding sending anyone to Raymond. My brother and I thought that together and we both determined that my brother Louis had not sent anyone to Mr. Jehl's place of business. Mr. Jehl did not as far as I know at any time ask my brother to testify falsely in this case. My father and I did not object to my brother being involved in a case in Federal Court, but we did object to my brother committing perjury.

Whereupon, both the Government and the defendants rested their cases.

Thereafter, the cause was argued to the jury by counsel for both the Government and for the defendants.

Thereafter, the argument having been concluded, the court proceeded to instruct the jury.

The instructions of the court are not here in-

cluded in this Bill of Exceptions for the reason that no exceptions were taken to the charge of the court by the defendants and no point is now made on this appeal, but the court did not properly instruct the jury on questions of law.

Thereafter, instructions of the court having been concluded, the case was submitted to the jury and thereupon at 2:10 o'clock P.M. on Friday, June 27th, 1941, the jury retired to deliberate upon their verdict. That thereafter, at 3:40 o'clock P.M. of the same day the jury returned to court with a verdict which found the defendants and each of them guilty on all nine counts of the indictment.

Thereupon, counsel for the defendant Jehl moved the Court for a new trial upon all the statutory grounds, particularly, that [80] the evidence was insufficient as a matter of law to sustain the verdict, which motion for a new trial was by the court denied, to the denial of which exception was taken.

Thereupon, counsel for the defendant Jehl moved the court in arrest of judgment upon all the statutory grounds which motion in arrest of judgment was by the court denied.

The said motion for a new trial and in arrest of judgment having been denied, the court proceeded to the passing of judgment upon the defendants and thereafter, and on June 27th, 1941, the court imposed judgment and sentence as follows:

That the defendants, and each of them, be imprisoned for a term of two years on each of counts 1, 3, 4, 5, 6 and 9 of said indictment, and for a term

of three years on count 7 of said indictment; the terms of imprisonment on counts 1, 3, 4, 5, 6 and 9 to run concurrently and the term of imprisonment on count 7 to run consecutively with and at the expiration of the sentences on counts 1, 3, 4, 5, 6 and 9, and said defendants to pay fines in the sum of on count 1, \$500.00; count 2, \$1,000.00; count 3, \$500.00; count 4, \$100.00; count 5, \$500.00; count 6, \$500.00; count 8, \$500.00; and to pay penalty in the sum of, on count 1, \$100.00 and count 2, \$100.00. The said terms of imprisonment to be served in the United States Penitentiary to be designated by the Attorney General of the United States.

That the above Bill of Exceptions contains all of the evidence, oral and documentary, and all of the proceedings relating to the trial, conviction and motion for a new trial, motion in arrest of judgment and judgment and sentence. [81]

Dated: September 3rd, 1941.

JAMES B. O'CONNOR

Attorney for Defendant Raymond Jehl [82]

[Title of District Court and Cause.]

STIPULATION RE EXHIBITS

It is hereby stipulated by and between the attorney for the United States and the attorney for the defendant in the above entitled action that the original exhibits that were introduced in the course

of the trial of the above entitled action may be made a part of this Bill of Exceptions and included herein as a part hereof.

Dated: September 17, 1941.

JAMES B. O'CONNOR

Attorney for Defendant

FRANK J. HENNESSY

United States Attorney

VALENTINE C. HAMMACK

Assistant United States At-
torney

Attorney for Plaintiff

So ordered:

A. F. ST. SURE

United States District Judge.

[83]

[Title of District Court and Cause.]

STIPULATION RE BILL OF EXCEPTIONS

It is hereby stipulated by and between the attorney for the United States and the attorney for the defendant that the foregoing Bill of Exceptions on behalf of the above named defendant on appeal herein to the Circuit Court of Appeals, in and for the Ninth Circuit, has duly been presented within the time allowed by law and rules, and the orders of this Court duly and regularly made in this behalf, and the proposed amendments of plaintiff herein to said Bill of Exceptions have been con-

ceded to be correct by defendant and have been incorporated herein and that the same is in proper form and conforms to the truth and that it may be settled, allowed, settled and authenticated by this Court as the true Bill of Exceptions herein on behalf of said defendant and that it may be made a part of the record in this case.

Dated: September 17, 1941.

JAMES B. O'CONNOR

Attorney for Defendant

FRANK J. HENNESSY

United States Attorney

VALENTINE C. HAMMACK

Assistant United States At-
torney

Attorney for Plaintiff [84]

[Title of District Court and Cause.]

ORDER SETTLING, ALLOWING AND AU-
THENTICATING BILL OF EXCEPTIONS
AND MAKING THE SAME PART OF THE
RECORD

The foregoing Bill of Exceptions duly presented by the defendant, Raymond H. Jehl, and duly agreed to by the respective parties hereto, having been presented to the Court within the time allowed and required by law and by the rules and order of this Court duly and regularly made in that behalf, is hereby settled, allowed, signed and authenticated as in proper form and in conformity with

the truth and as the true Bill of Exceptions herein, and is hereby made a part of the record in this case.

Dated: September 18, 1941.

A. F. ST. SURE

United States District Judge

[Endorsed]: Lodged Sept. 3, 1941. Filed Sep. 18, 1941. [85]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Name and address of appellant: Raymond H. Jehl, Watsonville, Santa Cruz County, California.

Name and address of appellant's attorney: James B. O'Connor, Balfour Building, San Francisco.

Offense: Sections 2810(a), 2812, 2814(a), 2833(a), 2834, 2834, 3320, Internal Revenue Code; and Section 88 of Title 18, U.S.C.A. Violation of the Internal Revenue Laws respecting illicit stills, and conspiracy to violate the same.

Date of Judgment: June 27, 1941.

Brief description of judgment or sentence: The defendant was sentenced by the above entitled Court to a total period of five years in the United States Penitentiary, to total fines of \$3600.00, and to certain penalties.

Name of prison where now confined, if not on bail; County Jail of the City and County of San Francisco.

I, the above named Appellant, hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment above mentioned on the grounds set forth hereafter.

Dated: June 30th, 1941.

RAYMOND H. JEHL

Appellant [86]

Grounds of Appeal:

(1) The insufficiency of the evidence as a matter of law to sustain the findings of the trial court that the defendant was guilty of the offenses charged.

(2) The trial court erred in denying defendant's motion for an order finding him not guilty of each and every count of the indictment because of the insufficiency of the evidence to sustain the conviction as a matter of law.

(3) The court erred in reception of evidence during the course of the trial, to the reception of which evidence the defendant objected and excepted.

(4) The court erred in his instructions to the jury wherein he made reference to the fact that there had been a former trial of the same case wherein the jury had disagreed, and in stating to the jury that other and different evidence had been offered at the trial at which defendant was convicted.

(5) The court erred in denying defendant's motion for a new trial.

(6) The court erred in denying defendant's motion in arrest of judgment.

Dated: June 30th, 1941.

JAMES B. O'CONNOR

Attorney for Appellant

[Endorsed]: Filed Jun. 30, 1941. [87]

[Title of District Court and Cause.]

ASSIGNMENT OF ERRORS

Raymond H. Jehl, the defendant in the above entitled action, and plaintiff on appeal herein, having appealed to the United States Circuit Court of Appeals, in and for the Ninth Circuit from the judgment and sentence entered in the above entitled cause against him, and said defendant having given notice of appeal, as provided by law, now makes and files the following Assignment of Errors herein, upon which he will rely for a reversal of said judgment and sentence upon appeal, and which errors and each of them are to the great detriment, injury and prejudice of said defendant and in violation of the rights conferred upon him by law, and the defendant says that in the recorded proceedings of the above entitled cause upon the hearing and determination thereof, in the Southern Division of the United States District Court for the Northern District *Court* of California, there is manifest error in this, to-wit:

I.

That the court erred in denying the motion of the defendant for a directed verdict of not guilty at the conclusion of the testimony [88] offered on behalf of the United States upon the ground that the evidence was insufficient as a matter of law to support a conviction at the conclusion of the Government's case in chief.

To which ruling of the court, the defendant duly and regularly excepted.

II.

That the court erred in denying the motion of the defendant for a directed verdict of not guilty made at the conclusion of the case for the defendants upon the ground that the evidence was insufficient as a matter of law to sustain a conviction under said indictment.

To which ruling of the court, the defendant duly and regularly excepted.

III.

That the court erred in denying defendant's motion for a new trial.

To which ruling of the court, the defendant duly and regularly excepted.

IV.

That the court erred in denying the defendant's motion in arrest of judgment.

To which ruling of the court, the defendant duly and regularly excepted.

Wherefore, for the manifest errors committed by the court, the defendant prays that said judgment and conviction and sentence be reversed, and for such other and proper relief as to the court [88A] may seem meet and proper.

Dated: September 3rd, 1941.

JAMES B. O'CONNOR,
Attorney for Defendant
and Appellant [89]

District Court of the United States
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

I, Walter B. Maling, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 89 pages, numbered from 1 to 89, inclusive, contain a full, true, and correct transcript of the records and proceedings in the case of United States vs. Raymond H. Jehl No. 27235-S, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of \$4.80 and that the said amount has been paid to me by the Attorney for the appellant herein.

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 29th day of September, A. D. 1941.

(Seal)

WALTER B. MALING,

Clerk.

J. P. WELSH,

Deputy Clerk. [90]

[Endorsed]: No. 9905. United States Circuit Court of Appeals for the Ninth Circuit. Raymond H. Jehl, Appellant, vs. United States of America, Appellee. Transcript of Record Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed October 2, 1941.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

Case No. 9905

RAYMOND H. JEHL,

Defendant and Appellant,

vs.

UNITED STATES OF AMERICA,

Plaintiff and Respondent.

STATEMENT OF POINTS AND DESIGNA-
TION OF PARTS OF RECORD TO BE
PRINTED

Raymond H. Jehl, the defendant and appellant in the above entitled action, hereby files herewith the following statement of the points upon which he intends to rely upon this appeal and herewith designates the parts of the record which he thinks necessary for the consideration thereof.

STATEMENT OF POINTS UPON WHICH HE
INTENDS TO RELY

That the Court below erred in denying defendant's motion for a directed verdict made at the conclusion of the case of the United States and at the conclusion of the case of the defendant, which motions were made upon the ground that the evidence was insufficient as a matter of law to sustain a conviction.

PARTS OF THE RECORD NECESSARY FOR
CONSIDERATION OF APPEAL

Defendant and appellant designates the entire record [91] filed in this Court as necessary for a proper consideration of this appeal.

Dated: October 31st, 1941.

JAMES B. O'CONNOR

Attorney for Defendant
and Appellant

Received a copy of the within Statement of Points and Designation of Parts of Record to be Printed is hereby admitted this day of October, 1941.

FRANK J. HENNESSY

United States Attorney

By W. F. MATHEWSON

Assistant United States Attorney

[Endorsed]: Filed Oct. 31, 1941. Paul P. O'Brien,
Clerk.

No. 9905

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

RAYMOND H. JEHL,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

OPENING BRIEF FOR APPELLANT.

JAMES B. O'CONNOR,

Balfour Building, San Francisco.

Attorney for Appellant.

FILED

FEB 3 - 1942

PAUL P. O'BRIEN,
CLERK

Subject Index

	Page
Statement of the Case.....	2
Summary of the Evidence.....	9
Specification of Error Relied Upon.....	18
A. The court erred in denying the motion of appellant for a directed verdict of not guilty.....	18
Conclusion	21

Table of Authorities Cited

Cases	Pages
Cady v. U. S., 293 Fed. 829.....	20
Tinsley v. U. S., 43 Fed. (2d) 890.....	20
United States v. Cusimono, 123 Fed. (2d) 611.....	20
United States v. Falcone, 311 U. S. 205, 61 S. Ct. 204.....	21
United States v. Sall, 116 Fed. (2d) 745.....	19

Codes

18 U. S. C. A., Sec. 88.....	1
26 U. S. C. A. 2810 (a).....	1, 2
26 U. S. C. A. 2812.....	1, 2
26 U. S. C. A. 2814.....	1, 2
26 U. S. C. A. 2833 (a).....	1
26 U. S. C. A. 2834.....	1
26 U. S. C. A. 3321.....	1
26 U. S. C. A. 3320.....	1
28 U. S. C. A., Sec. 225.....	1

No. 9905

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

RAYMOND H. JEHL,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

OPENING BRIEF FOR APPELLANT.

JURISDICTION.

The trial Court had jurisdiction under an indictment charging violations of the following sections: 18 U. S. C. A., Sec. 88; 26 U. S. C. A. 2810 (a); 26 U. S. C. A. 2812; 26 U. S. C. A. 2814; 26 U. S. C. A. 2833 (a); 26 U. S. C. A. 2834; 26 U. S. C. A. 3321; 26 U. S. C. A. 3320.

This Court has jurisdiction under Section 128 (a) of the Judicial Code, as amended by Act of February 15, 1925. (28 U. S. C. A., Sec. 225.)

STATEMENT OF THE CASE.

Raymond H. Jehl, the appellant, was indicted by the Grand Jury for the Northern District of California, Southern Division, on the 6th day of May, 1941.

The indictment charged appellant in nine (9) counts with various violations of the Internal Revenue Code with respect to the illicit operation of a still and a conspiracy to operate an illicit still.

The indictment charges that the substantive offenses were committed on the 28th day of August, 1940, on a ranch near Watsonville, Santa Cruz County, California.

The indictment further charges that the conspiracy was to violate the various substantive offenses charged and that the conspiracy was entered into at or about the time alleged in the substantive counts.

The various counts in the indictment allege:

The First Count, the defendants knowingly had in their possession and custody and under their control for the distillation of alcohol, a still and distilling apparatus set up without having registered the same in the manner prescribed by Section 2810 (a) of the Internal Revenue Code.

The Second Count, defendants were engaged in the business of a distiller of alcohol, and then and there wilfully failed to give the notice prescribed by Section 2812 of the Internal Revenue Code.

The Third Count, defendants having then and there commenced the business of distillers of alcohol, wil-

fully failed to give the bond prescribed by Section 2814 (a) (1) of the Internal Revenue Code.

The Fourth Count, that at the time and place described in the first count of this indictment said defendants wilfully engaged in and carried on the business of a distiller of alcohol, with intent to defraud the United States of the tax on the spirits distilled by them.

The Fifth Count, in a building and on premises at said place, said defendants knowingly made and fermented mash, wort and wash, fit for distillation and for the production of alcohol, other than in a distillery duly authorized according to law.

The Sixth Count, said defendants, not then nor there being authorized distillers, knowingly separated by distillation the alcoholic spirits from fermented mash, wort and wash.

The Seventh Count, said defendants did then and there unlawfully, wilfully and knowingly deposit and conceal certain goods and commodities, to-wit, approximately 10 gallons of alcohol, and 100 gallons of whiskey, upon which said goods and commodities there were then and there imposed certain taxes under the Internal Revenue Code.

The Eighth Count, said defendants then and there knowingly and wilfully did have in their possession with intent to sell the same in fraud of the Internal Revenue laws of the United States the said goods and commodities described in the Seventh Count of this indictment upon which there were then and

there due, imposed and unpaid certain taxes to the United States of America.

The Ninth Count, that said defendants, at a time and place to said Grand Jurors unknown, did knowingly, wilfully, unlawfully, corruptly and feloniously conspire, combine, confederate, arrange and agree together, and with divers other persons whose names are to the Grand Jurors unknown, to commit offenses against the United States of America, and the laws thereof, the offenses being to knowingly, wilfully, unlawfully, and feloniously violate the Internal Revenue laws of the United States

(1) By possessing and controlling for the distillation of alcohol a still and distilling apparatus set up, without having registered the same in the manner prescribed by law;

(2) by engaging in the business of distillers of alcohol without having given the notice prescribed by law;

(3) by having commenced the business of distillers of alcohol, having wilfully failed to give the bond prescribed by law;

(4) by engaging in and carrying on the business of distillers of alcohol with intent to defraud the United States of the taxes on the spirits distilled by them;

(5) by knowingly making and fermenting mash, wort and wash fit for distillation and for the production of alcohol in a building and on premises other than in a distillery duly authorized according to law;

(6) by separating by distillation, alcoholic spirits from fermented mash, wort and wash without being registered distillers;

(7) by removing, concealing and depositing tax unpaid distilled spirits with intent to defraud the United States of the tax imposed thereon;

(8) by possessing, buying, selling, transferring and transporting distilled spirits in immediate containers not having thereto affixed the stamps prescribed by law denoting the quantity of spirits therein and evidencing payment of all Internal Revenue taxes imposed thereon;

(9) by removing to and depositing in premises other than an Internal Revenue Bonded Warehouse tax unpaid distilled spirits;

(10) by having in their possession and custody tax unpaid distilled spirits for the purpose of selling the same in fraud of the Internal Revenue laws and with design to avoid payment of the tax imposed thereon;

(11) and by carrying on the business of wholesale liquor dealers without having paid the special tax therefor as required by law.

And the said Grand Jurors, upon their oaths aforesaid, do further charge and present that in pursuance of, and in furtherance of, in execution of, and for the purpose of carrying out and to effect the object, design and purposes of said conspiracy, combination, confederation and agreement aforesaid, the hereinafter named defendants did at the times hereinafter set forth, commit the following overt acts

within the Southern Division of the Northern District of California, and within the jurisdiction of this Court:

1. On or about March 9, 1940, in the City of Watsonville, County of Santa Cruz, State of California, said defendants Tony Rodrigues and John A. Woodworth signed a lease for the premises known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

2. On or about April 2, 1940, in the City of Watsonville, County of Santa Cruz, California, said defendant Lester A. Woodworth signed an application for electric service for the premises known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

3. On or about June 15, 1940, said defendant Raymond Jehl bought ten 100-lb. sacks of sugar from the Independent Grocery Company, located at 169 Main Street in the City of Watsonville, County of Santa Cruz, California.

4. On or about August 28, 1940, said defendant Tony Rodrigues operated a still at a place known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

To the indictment in question the appealing defendant entered a plea of not guilty.

The defendant Rodrigues pleaded guilty. The defendant Woodworth pleaded not guilty and was convicted at the trial from which the appellant Jehl urges this appeal. Woodworth is not a party to this appeal.

The appellant was convicted by a verdict of a jury on June 27, 1941. The appellant was found guilty of all the nine counts contained in the indictment. (Tr. R. pp. 7, 8.)

The appellant was sentenced by the trial Court as follows:

Upon Count One of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Two of the Indictment to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of One Thousand and No/100 Dollars (\$1000.00);

Upon Count Three of the Indictment for the period of Two (2) Years and pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Four of the Indictment for the period of Two (2) Years and pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00);

Upon Count Five of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Six of the Indictment for the period of Two (2) Years and to pay a fine to the United

States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Seven of the Indictment for the period of Three (3) Years;

Upon Count Eight of the Indictment to pay penalty to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Nine of the Indictment for the period of Two (2) Years;

It Is Further Ordered that the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, Six, and Nine, run concurrently; that the period of imprisonment imposed on the defendant on the Seventh Count of the Indictment begin and run from and after the expiration or execution of the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, and Six of the Indictment.

The appellant was thus sentenced to a full term of five years. (Tr. R. pp. 10, 11.)

Appellant moved the trial Court for a directed verdict of not guilty at the conclusion of the Government's case in chief, which motion was denied, to which denial an exception was taken. (Tr. R. p. 48.)

The appellant at the conclusion of defendant's case renewed his motion for a directed verdict, which motion was denied and an exception taken. (Tr. R. p. 90.)

Appellant moved the trial Court for a new trial on the ground that the evidence was insufficient as a

matter of law to sustain the verdict. This motion was denied, to which denial an exception was duly taken. (Tr. R. p. 105.)

The assignment of errors of appellant was filed within the time set by the trial Court. The Bill of Exceptions was settled and allowed by the trial Court within the time set by said Court. (Tr. R. pp. 108, 109.)

A SUMMARY OF THE EVIDENCE.

On August 28, 1940, certain agents of the Alcohol Tax Unit of the Bureau of Internal Revenue seized a still and the usual equipment used in its operation on a ranch known as the E. A. Hall Ranch, outside of Watsonville, Santa Cruz County, California. At the time of the seizure the officers arrested the defendant Tony Rodrigues in the still building. About midnight of the night of the seizure the defendant Woodworth drove up to the premises with his wife and step-daughter and was arrested. Rodrigues admitted his connection with the still. Woodworth denied being directly connected with the still. He told the officers he lived in a house next to the still and that he and Rodrigues leased the ranch to farm and raise hogs, but that they had leased the barn to an Italian whom he, Woodworth, could not describe.

The officers found 110 gallons of whiskey at the still. The still, according to the officers, was capable of producing 160 gallons of alcohol a day.

The still was illicit and the taxes required by the Internal Revenue laws were not paid.

The son of the owner of the ranch testified that his father rented the premises to Rodrigues and Woodworth for the purpose of raising hogs, corn and beans. He also said the house occupied by Woodworth was built by Rodrigues and Woodworth.

An official of a gas and electric company testified that electric service for the premises was in the name of Woodworth and that the readings showed the service to have started on April 2, 1940. The readings showed normal service for the first three months. During July and August the service was above normal.

Earl Goon, a Chinese grocer of Watsonville, California, testified that he knew the appellant, Raymond Jehl; that sometime in May or June, 1940, appellant Jehl came to his store with another man and asked if he could buy sugar in ten (10) sack lots. Goon agreed to this and a price was set. Goon said this price was a little higher than his usual price. About three weeks after the first visit to the grocery store, Goon said, appellant Jehl came to the store and placed an order for ten (10) sacks of sugar and told Goon someone would pick them up. A day or so later defendant Rodrigues picked the sugar up. About a week later appellant Jehl ordered sugar again and paid for it. Rodrigues picked this sugar up also. Goon testified that Jehl ordered sugar and paid for it about three times. Defendant Rodrigues paid for sugar three times but Jehl ordered it. On one occasion the sugar was ordered by telephone.

Goon testified that he read in the paper about the seizure of a still at the Hall ranch and that a few

days thereafter Jehl came to his store and told Goon not to worry. Goon told Jehl that Government agents had been to see him and Jehl said it was just a routine matter. Goon said on one occasion Woodworth picked up sugar that had been ordered by Jehl.

There was no conversation between Goon and Jehl or the man who was present on the first occasion to the effect that the sugar was to be used in an illicit still, or in connection with a distillery. Jehl did not ask Goon to tell the Government agents any particular story and did not tell him what to say to them. He at no time mentioned a still to Goon.

Joe Carrillo testified that during the year 1940 he worked on and off at the Colonial Inn, near San Jose, California, as a musician; that in the latter part of June or the first part of July the Colonial Inn was owned by appellant Jehl and Carillo then went to work for him. He said he had a conversation with Jehl sometime in the latter part of August or September. That there were present at this conversation the witness Carillo, his wife, appellant Jehl and a bartender and a few others. He said appellant was talking to Mrs. Carillo and said to her that he was in the "dumps". Appellant Jehl said, "I had to go to San Francisco and get some of my men out of jail. It made me feel bad; cost me some money." Appellant Jehl is alleged to have said he had to get some men out of jail for running a still and that it was his still. The witness admitted he had a dispute with appellant over wages and quit his employment. He admitted appellant never told him point blank that

he had a still but the witness gathered this from the conversation appellant had with the witness' wife. On no other occasion, directly or indirectly, did appellant indicate he was interested in a still. The bartender was a man named Tony Amiziet.

Della Carrillo testified for the Government that during the year 1940 she was employed as a cook, waitress, dishwasher and hostess at the Colonial Inn for appellant Jehl. Sometime in September, 1940, she said she had a conversation with appellant at which were present besides herself and appellant, her husband and the bartender. Appellant at that time said he had been to San Francisco to see about bailing out a couple of his men. On another occasion, in the first part of August, appellant said to the witness, "It was awful to stand on a hill and watch thousands of dollars go to waste." The witness Della Carrillo testified that a few days before the first trial of this case, which trial resulted in a disagreement, appellant, with Woodworth and Rodrigues, came to the Colonial Inn. At that time the appellant asked her if anyone had been to see her about the case. She told him that agents had been to see her and had showed her some pictures which she identified. She said appellant told her, "Remember, you don't know anything." On another occasion in the latter part of August she said she heard appellant tell the bartender he had to go away for awhile because things were getting hot and he was going to Reno. On cross-examination, after being shown her testimony at the first trial, the witness admitted that at

the conversation concerning the bailing of men out, no mention was made of a still. She admitted that at the first trial nothing was ever said about a still and that she knew nothing about a still.

The Government rested its case.

The defendant Woodworth called as witnesses in his behalf Ferdinand Bock and Clyde H. Hines. These witnesses did not give any testimony affecting the appellant.

The defendant Woodworth testified as a witness in his own behalf but gave no testimony affecting appellant Jehl except he admitted he went to the grocery store of Mr. Goon and picked up four sacks of sugar for Mr. Rodrigues which he took to the Hall Ranch.

The appellant called Eugene E. Glorr, a physician and surgeon of Watsonville, California, who testified that appellant was a patient of his and that in the early part of 1940, he advised appellant to seek a warmer climate than Watsonville and to seek a change of activity. The doctor did not advise that appellant go into the night club business.

Angelo Gordon Amiziet, called by appellant, testified he was the bartender at the Colonial Inn. This witness, when his attention was directed to the testimony of Mr. and Mrs. Carillo, denied that the conversations to which they testified ever took place in his presence. He also testified that when appellant was not at the Colonial Inn he, the witness, was in charge.

The appellant Jehl testified as a witness in his own behalf as follows:

That he was a married man and had one daughter. That he had lived in Watsonville for about thirty years continuously except when overseas during the last world war. That he was a licensed real estate broker and had been such since 1913 or 1914, and had his office in Watsonville with his brother. That during the period of January, 1940 to September, 1940, he and his brother were agents for a subdivision in Watsonville. That Dr. Glorr advised him to seek a change of climate and a different type of business. During June 1940 he went into possession of the Colonial Inn. He lived part of this time at the Colonial Inn and part of the time at his home in Watsonville. He employed Mr. and Mrs. Carrillo. Angelo Amiziet was his manager at the Colonial Inn.

He had known Earl Goon for several years. In May of 1940 a Mr. Giorodini came to his place of business in Watsonville and presented a card from Louis Hirsch, a jeweler, who had a store in San Jose and one in Salinas, California. Giorodini asked him if he knew the Independent Grocery and asked him to introduce Giorodini to the grocer. He took Giorodini to the grocery and introduced him to Mr. Goon. The men conversed about different things, sugar being one of them. Price and amounts of sugar were discussed. No order was placed at that time. Giorodini and appellant left the grocery. Appellant told Giorodini he was to take over the Colonial Inn. Giorodini came to the Colonial Inn later on several

occasions, sometimes alone and sometimes with others. On one of these occasions he asked appellant to take some money for him to Mr. Goon, when appellant went to Watsonville. He gave appellant \$45 or \$50 which he, appellant, gave to Mr. Goon the next day in Watsonville. He told Mr. Goon that Giorodini had sent the money and for Goon to set aside some sugar which Giorodini said he would have picked up.

Appellant took money to Mr. Goon on about three occasions but did not know what the sugar was to be used for. He learned for the first time that this sugar was used in connection with a still in September, 1940. At that time one of the men who used to come to the Colonial Inn, with Giorodini, came there and asked appellant if he knew Giorodini's still had been knocked over. Appellant replied he did not know Giorodini was in that kind of business. This man asked appellant if anyone had questioned him. This man then told him the money he took to Goon for the sugar was connected with the still and that the sugar was used in the still. He attempted to get in touch with Goon by phone but got Goon's brother and told him not to give Giorodini any more sugar. He later saw Mr. Goon who told him Government agents had been to see him. He did not ask Mr. Goon to withhold any information concerning appellant's activity in connection with the purchase of sugar.

Appellant denied the alleged conversation with Mr. and Mrs. Carrillo concerning bailing men out and concerning stills. He also denied the other conversations with Mrs. Carrillo. He admitted that prior to

his first trial he went to the Colonial Inn and saw Mrs. Carrillo. In this connection, he admitted he knew Rodrigues casually around Watsonville but met Woodworth for the first time in the office of Mr. Abrams, his attorney, after the indictment had been returned. Mr. Abrams had told him Mrs. Carrillo was to be a witness at the trial and wanted appellant to stop at the Colonial Inn on his way home from San Francisco, to find out if she was to be a witness. He stopped at the Colonial Inn and was told by Mrs. Carrillo that she had been interviewed but that she did not know anything. He last saw Giorodini in the middle of August. He did not know where he lived but had endeavored to find out.

The appellant rested his case and renewed his motion for a directed verdict and excepted to the denial of his motion.

In rebuttal the Government called David Levin, Charles J. Healey, Clay Gaines and John Becker. These witnesses gave no testimony concerning the appellant Jehl.

Louis Hirsch was called in rebuttal as a witness against appellant. He testified that he was in the jewelry business in Salinas, California. He had known appellant Jehl for twelve to fifteen years. He did not know a man named Giorodini and did not give such a man one of his business cards to be delivered to appellant Jehl in Watsonville. A few days prior to this trial appellant Jehl came to Hirsch's place of business and wanted him to remember the fact that such a card had been given. He told Jehl

he did not remember such a thing. Jehl wanted him to try and remember and to so testify. Hirsch said he remembered no such thing and would not so testify. Jehl seemed to be sure Hirsch had sent the man to him. Jehl did not ask Hirsch to perjure himself. Jehl insisted to Hirsch that Hirsch had sent this man to him. Hirsch said he could have sent the man to Jehl but did not remember anything like that coming up.

The appellant Jehl, called in his own behalf, admitted he went to see Louis Hirsch before the trial and asked him about the man Hirsch had sent to him. Hirsch did not remember sending Giorodini to him but admitted he had sent other people to him. Jehl said he did not ask Hirsch to testify falsely. Jehl said that he had talked to Alex Hirsch on the phone but denied Alex Hirsch asked Jehl to "lay off" his brother Louis.

Alex B. Hirsch, called by the Government, testified he was a brother of Louis Hirsch and had told appellant on the phone that Louis was not going to do what appellant wanted him to do. Jehl told the witness he did not want to discuss the matter on the phone. Jehl did not ask anyone to commit perjury. As far as the witness knew, appellant at no time asked his brother Louis to testify falsely.

The above summary of the evidence is somewhat lengthy, but the writer believes, because of the fact that the sole question on this appeal is the sufficiency of the evidence to sustain the verdict, it is necessary to set forth the evidence in detail.

SPECIFICATION OF ERRORS RELIED UPON.

THE COURT ERRED IN DENYING THE MOTION OF APPELLANT
FOR A DIRECTED VERDICT OF NOT GUILTY. (Assignment of
Errors I, II, III, Tr. R. p. 112.)

The assignments of errors contained in assignments I, II and III may be treated under one heading since they all relate to the sufficiency of the evidence to sustain the verdict and to the question whether as a matter of law the trial Court should have directed the jury to return a verdict of not guilty as to appellant on all nine counts contained in the indictment.

The first eight counts of the indictment charge substantive violations of the Internal Revenue laws with respect to the operation of an illicit still. The ninth count charges a conspiracy to violate the statutes covered by the first eight counts.

We believe that the entire evidence upon which the Government must rely to sustain the conviction of appellant may be summed up as follows:

A. The purchase of sugar by appellant on six occasions.

B. Alleged admissions made by appellant, wholly unconnected with the subject matter of the indictment.

In connection with the substantive offenses contained in the indictment, we point out that there is no evidence that appellant was even on the property where the still in question was found, that he knew a still was on such property, that he ever worked on or near said still or that he had any interest in the still that was the subject matter of the indictment. Without enumerating in detail the charges

contained in the first eight counts, we submit there is no evidence to show appellant did any of the things made criminal by the statutes involved in said first eight counts.

With respect to the substantive counts, we submit, the evidence is wholly insufficient to sustain appellant's conviction. In this connection we direct the Court's attention to the language of the Circuit Court of Appeals for the Third Circuit in *United States v. Sall*, 116 Fed. (2d) 745 at 747:

“Although that offence may in fact have been committed in the course of the conspiracy, it is still necessary to prove that the defendant, even though he had joined the conspiracy, had also joined at least to the extent we have indicated in the concealment of alcohol which constitutes the substantive offence with which he is charged. It is the act of concealment with criminal intent and not the previous agreement, which is the gist of that offence. To hold otherwise would be to ignore the difference in character between the crime of conspiracy and substantive crimes which may result from it and to enable the government through the use of the conspiracy dragnet to convict a conspirator of every substantive offence committed by any other member of the group even though he had no part in it or even knowledge of it.”

In the present case, assuming but not conceding, that the evidence sustains the conspiracy count against appellant, we contend it is wholly insufficient as to the substantive offences.

We believe our contention in this regard is supported by the opinion of the Circuit Court for the Seventh Circuit in the recent case of *United States v. Cusimono*, 123 Fed. (2d) 611.

With respect to the count charging the conspiracy, we respectfully submit there is not sufficient evidence in the record to support the conviction of appellant of the conspiracy charged.

It was the duty of the trial Court to direct a verdict of not guilty if the evidence was insufficient as a matter of law to support the conviction.

Tinsley v. U. S., 43 Fed. (2d) 890;

Cady v. U. S., 293 Fed. 829.

Assuming every fact testified to on behalf of the Government against appellant to be true, as we must on consideration of the failure of the trial Court to direct the verdict, we maintain there is a complete lack of evidence that appellant did any more than assist in the buying of sugar. There is no evidence that he knew of the existence of the still mentioned in the indictment.

Even if we assume that appellant purchased sugar to use in an illicit still, how is he connected with the still, the subject matter of the indictment?

All of the acts of appellant, in and of themselves, are innocent acts, and unless there is some evidence in the record to bring home to him knowledge of the still and conspiracy charged, he is entitled to a reversal of the conviction against him.

We do not intend to burden the Court with further citation of authority on the question of the duty of the trial Court to direct a verdict where the evidence is insufficient as a matter of law to sustain a conviction.

With respect to the alleged admissions offered against appellant, we contend they in nowise connect him with the particular offenses charged against him. The only evidence against appellant is the purchase by him of sugar and under the opinion of the Supreme Court in *United States v. Falcone*, 311 U. S. 205, 61 S. Ct. 204, we submit this is not sufficient to sustain his conviction.

CONCLUSION.

We respectfully submit:

I. The evidence is wholly insufficient to support appellant's conviction of the substantive offenses.

II. The evidence is insufficient to connect appellant with the conspiracy charge.

III. The conviction of appellant should be reversed as to all counts.

Dated, San Francisco,

February 4, 1942.

Respectfully submitted,

JAMES B. O'CONNOR,

Attorney for Appellant.

No. 9905

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

RAYMOND H. JEHL,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR APPELLEE.

FRANK J. HENNESSY,
United States Attorney,

VALENTINE C. HAMMACK,
Assistant United States Attorney,
Post Office Building, San Francisco,
Attorneys for Appellee.

FILED

1913

WILLIAM P. O'BRYEN,

Subject Index

Jurisdictional Statement	Page 3
The Indictment	3
Appellant's Assignments of Error.....	8
Facts of the Case.....	9
Argument	15
Conclusion	21

Table of Authorities Cited

Cases	Page
Abrams v. United States, 250 U. S. 616, 619.....	15
Borgia v. United States (C. C. A. 9), 78 F. (2d) at page 555	19
Cossack v. United States (C. C. A. 9), 82 F. (2d) 214.....	16
Crono v. United States (C. C. A. 9), 59 F. (2d) 339, 340....	16
Hemphill v. United States (C. C. A. 9), 120 F. (2d) at page 117	16
Johnson v. United States (C. C. A. 9), 62 F. (2d) at page 34	19
Maugeri v. United States (C. C. A. 9), 80 F. (2d) 199, 202	16
Mullaney v. United States (C. C. A. 9), 82 F. (2d) 638-640	16
Pierce v. United States, 252 U. S. 239, 251-252.....	16
Stilson v. United States, 250 U. S. 583, 588.....	16
United States v. Cusimano (C. C. A. 7), 123 F. (2d) 611...20,	21
United States v. Sall (C. C. A. 3), 116 F. (2d) 745, at 747..	20
Vilson v. United States (C. C. A. 9), 61 F. (2d) 901.....	16
Vukich v. United States (C. C. A. 9), 28 F. (2d) at page 669	19

Statutes

Title 18 U. S. C. A., Section 550.....	20
Title 28 U. S. C., Section 41 (2).....	3
Title 28 U. S. C., Section 225.....	3

No. 9905

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

RAYMOND H. JEHL,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR APPELLEE.

Appeal from a judgment and order made by the United States District Court for the Southern Division of the Northern District of California, sentencing appellant on an indictment containing nine counts, following appellant's conviction on all nine of the same, as follows:

Upon Count One of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Two of the Indictment to pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00) and to pay a penalty of One Thousand and No/100 Dollars (\$1000.00);

Upon Count Three of the Indictment for the period of Two (2) Years and pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Four of the Indictment for the period of Two (2) Years and pay a fine to the United States in the sum of One Hundred and No/100 Dollars (\$100.00);

Upon Count Five of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Six of the Indictment for the period of Two (2) Years and to pay a fine to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Seven of the Indictment for the period of Three (3) Years;

Upon Count Eight of the Indictment to pay penalty to the United States in the sum of Five Hundred and No/100 Dollars (\$500.00);

Upon Count Nine of the Indictment for the period of Two (2) Years;

It Is Further Ordered that the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, Six, and Nine, run concurrently; that the period of imprisonment imposed on the defendant on the Seventh Count of the Indictment begin and run from and after the expiration or execution of the periods of imprisonment imposed on the defendant on Counts One, Three, Four, Five, and Six of the Indictment.

The appellant was thus sentenced to a full term of five years. (Tr. R. pp. 10, 11.)

JURISDICTIONAL STATEMENT.

Jurisdiction is conferred upon the trial court by 28 U.S.C. Section 41 (2) and upon this Court by 28 U.S.C. Section 225.

THE INDICTMENT.

The indictment charges the appellant as follows:

No.27235-S

In the Southern Division of the United States
District Court for the Northern District
of California

First Count: (R. S. 3258) 26 USCA 2810(a);

In the March 1941 term of said Division of said District Court, the Grand Jurors thereof, upon their oaths present:

That

Raymond H. Jehl
Tony Rodrigues, and
Lester A. Woodworth,

(hereinafter called "said defendants"), on the 28th day of August, 1940, at a place known as the E. A. Hall Ranch, Route 1, Box 77a, Watsonville, Santa Cruz County, State of California, within said Division and District, knowingly had in their possession and custody and under their control for the distillation of alcohol, a still and distilling apparatus set up without having registered the same in the manner prescribed by Section 2810 (a) of the Internal Revenue Code.

Second Count: (R. S. 3259) 26 USCA 2812:

And the said Grand Jurors, upon their oaths, do further present: That at the time and place

described in the first count of this indictment said defendants were engaged in the business of a distiller of alcohol, and then and there wilfully failed to give the notice prescribed by Section 2812 of The Internal Revenue Code.

Third Count: (R. S. 3260) 26 USCA 2814 (a) (1);

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment said defendants having then and there commenced the business of distillers of alcohol, wilfully failed to give the bond prescribed by Section 2814 (a) (1) of the Internal Revenue Code.

Fourth Count: (R. S. 3281) 26 USCA 2833 (a);

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment said defendants wilfully engaged in and carried on the business of a distiller of alcohol, with intent to defraud the United States of the tax on the spirits distilled by them.

Fifth Count: (R. S. 3282) 26 USCA 2834;

And the said Grand Jurors, upon their oaths, do further present: That at the time and place described in the first count of this indictment, in a building and on premises at said place, said defendants knowingly made and fermented mash, wort and wash, fit for distillation and for the production of alcohol, other than in a distillery duly authorized according to law.

Sixth Count: (R. S. 3282) 26 USCA 2834;

And the said Grand Jurors, upon their oaths, do further present: That at the time and place

described in the first count of this indictment, said defendants, not then nor there being authorized distillers, knowingly separated by distillation the alcoholic spirits from fermented mash, wort and wash.

Seventh Count: 26 USCA 3321;

And the said Grand Jurors upon their oaths do further present: That at the time and place described in the first count of this indictment said defendants did then and there unlawfully, wilfully and knowingly deposit and conceal certain goods and commodities, to-wit, approximately 10 gallons of alcohol, and 100 gallons of whiskey, upon which said goods and commodities there were then and there imposed certain taxes under the Internal Revenue laws of the United States; that said taxes imposed as aforesaid were then and there due and unpaid to the United States, and the said goods and commodities were deposited and concealed as aforesaid by said defendants with intent then and there to defraud the United States of said taxes.

Eighth Count: 26 USCA 3320;

And the said Grand Jurors upon their oaths do further present: That at the time and place described in the first count of this indictment said defendants then and there knowingly and wilfully did have in their possession with intent to sell the same in fraud of the Internal Revenue laws of the United States the said goods and commodities described in the Seventh Count of this Indictment upon which there were then and there due, imposed and unpaid certain taxes to the United States of America.

Ninth Count: 18 USCA Section 88;

And the said Grand Jurors upon their oaths aforesaid do further present: That said defendants, at a time and place to said Grand Jurors unknown, did knowingly, wilfully, unlawfully, corruptly and feloniously conspire, combine, confederate, arrange and agree together, and with divers other persons whose names are to the Grand Jurors unknown, to commit offenses against the United States of America, and the laws thereof, the offenses being to knowingly, wilfully, unlawfully, and feloniously violate the Internal Revenue laws of the United States

(1) By possessing and controlling for the distillation of alcohol a still and distilling apparatus set up, without having registered the same in the manner prescribed by law;

(2) by engaging in the business of distillers of alcohol without having given the notice prescribed by law;

(3) by having commenced the business of distillers of alcohol, having wilfully failed to give the bond prescribed by law;

(4) by engaging in and carrying on the business of distillers of alcohol with intent to defraud the United States of the taxes on the spirits distilled by them;

(5) by knowingly making and fermenting mash, wort and wash fit for distillation and for the production of alcohol in a building and on premises other than in a distillery duly authorized according to law;

(6) by separating by distillation, alcoholic spirits from fermented mash, wort and wash without being registered distillers;

(7) by removing, concealing and depositing tax unpaid distilled spirits with intent to defraud the United States of the tax imposed thereon;

(8) by possessing, buying, selling, transferring and transporting distilled spirits in immediate containers not having thereto affixed the stamps prescribed by law denoting the quantity of spirits therein and evidencing payment of all Internal Revenue taxes imposed thereon;

(9) by removing to and depositing in premises other than an Internal Revenue Bonded Warehouse tax unpaid distilled spirits;

(10) by having in their possession and custody tax unpaid distilled spirits for the purpose of selling the same in fraud of the Internal Revenue laws and with design to avoid payment of the tax imposed thereon;

(11) and by carrying on the business of wholesale liquor dealers without having paid the special tax therefor as required by law.

And the said Grand Jurors, upon their oaths aforesaid, do further charge and present that in pursuance of, and in furtherance of, in execution of, and for the purpose of carrying out and to effect the object, design and purposes of said conspiracy, combination, confederation and agreement aforesaid, the hereinafter named defendants did at the times hereinafter set forth, commit the following overt acts within the Southern Division of the Northern District of California, and within the jurisdiction of this Court:

1. On or about March 9, 1940, in the City of Watsonville, County of Santa Cruz, State of California, said defendants Tony Rodrigues and John A. Woodworth signed a lease for the premises

known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

2. On or about April 2, 1940 in the City of Watsonville, County of Santa Cruz, California, said defendant Lester A. Woodworth signed an application for electric service for the premises known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

3. On or about June 15, 1940 said defendant Raymond Jehl bought ten 100-lb sacks of sugar from the Independent Grocery Company, located at 169 Main Street in the City of Watsonville, County of Santa Cruz, California.

4. On or about August 28, 1940 said defendant Tony Rodrigues operated a still at a place known as the Hall Ranch, Route 1, Box 77A, Watsonville, California.

Frank J. Hennessy,
United States Attorney.

Approved as to Form:

R. B. McM.

(Endorsed): A true bill, Edward J. Dollard, Foreman. Presented in Open Court and Ordered Filed May 6, 1941. Walter B. Maling, Clerk. By C. W. Calbreath, Deputy Clerk.

APPELLANT'S ASSIGNMENTS OF ERROR.

Appellant assigns three errors:

(a) Appellant moved the Trial Court for a directed verdict of not guilty at the conclusion of the Government's case in chief, which motion was denied.

(b) The appellant, at the conclusion of defendant's case, renewed his motion for a directed verdict, which motion was denied.

(c) That the evidence was insufficient as a matter of law to sustain the verdict.

FACTS OF THE CASE.

On August 28, 1940 certain agents of the Alcohol Tax Unit of the Bureau of Internal Revenue seized a still and the usual equipment used in its operation on a ranch known as the E. A. Hall Ranch, approximately three miles outside Watsonville, Santa Cruz County, California. At the time of the seizure, which was about 9:00 o'clock in the evening, the still was in operation, and the officers arrested the defendant Tony Rodrigues inside the still building. About midnight of the night of the seizure of the still, the defendant Lester A. Woodworth drove up to the premises with his wife and stepdaughter, at which time and place the defendant Woodworth was arrested. The defendant Rodrigues admitted his connection with the still. The defendant Woodworth denied any connection with the still, and further denied any knowledge that the same was located inside the barn on the premises. Woodworth told the officers he lived on the place with his wife and stepdaughter next to the still, and that he and Rodrigues had leased the ranch to farm and raise hogs, but that the same did not turn out so well, and that thereafter he and Rodrigues had leased the barn

to an Italian whom he, Woodworth, could not name or describe.

The officers found 110 gallons of whiskey at the still. The still, according to the officers, was capable of producing 160 gallons of alcohol a day.

The still was illicit and the permits and taxes required by the Internal Revenue Laws were not secured nor paid.

Charles B. Hall, son of the owner of the ranch, testified that the ranch had been leased to the defendants Rodrigues and Woodworth on March 9, 1940. These defendants stated to Hall they were leasing the ranch for the purpose of raising hogs, corn, and beans. Hall further testified that Rodrigues and Woodworth built the house on the ranch in which Woodworth was living, and that the house cost approximately \$150.00 to build. Hall further testified that following the leasing of the premises he visited the same at least eight times, and never saw any evidence of farming.

Frank Thomas, an official of a gas and electric company, testified that electric service for the premises was in the name of Woodworth and that the readings on the meter showed the service to have started on April 2, 1940. The meter readings showed normal use of service for the first three months. During the months of July and August 1940, the use of electric service was above normal.

Earl Goon testified that he was engaged in the grocery business in Watsonville, California; that he knew the defendant Raymond H. Jehl. He further

testified that sometime in May or June of 1940 Jehl came to his grocery store, and in a conversation Jehl asked at that time if he could buy sugar in ten sack lots. They discussed the price, and Goon mentioned a price a little higher than he usually charged. He stated further that about three weeks later Jehl came to his store and placed an order for ten sacks of sugar and told Goon that someone would pick it up. Jehl did not say who would pick up the sugar, but a day or so later the sugar was picked up by the defendant Rodrigues. Goon further testified that about a week later he sold ten sacks of sugar again to Jehl, for which Jehl paid him, and later the same thing happened again; that when the sugar was ordered by Jehl, he, Goon, would place it in the back room, and in the evening, about 6:00 o'clock, Rodrigues would come and pick the sugar up; that there is an alley in the rear of the store, and when Rodrigues picked up the sugar he would come in the alley in the rear of the store; that Jehl paid him three times for sugar and Rodrigues paid him three times for sugar, but that Jehl ordered the sugar in all instances; that on one occasion Jehl ordered sugar over the long distance telephone, and said someone would pick it up. In all, six different sales of sugar were made to Jehl between May 1940 and the 1st of August, 1940. Goon further testified that on one occasion Jehl ordered sugar and the same was picked up by the defendant Woodworth; that on the first occasion Jehl came to his store to discuss the purchase of sugar, that he, Jehl, was accompanied by another man; there was

no conversation with this man, and after this first time he was not seen again; that following the seizure of the still, Jehl came in to the store to see him, at which time Goon told Jehl that he, Goon, had been interviewed by Government officers, and Jehl said not to worry, that it was just a routine matter (Tr. pp. 33-38).

Joe Carrillo testified that he worked at the Colonial Inn, a night club and restaurant located in San Jose, California, on occasions during the year 1940; that the defendant Raymond Jehl owned the Colonial Inn and that in a conversation with Jehl at the Colonial Inn in the latter part of August, 1940, or the first part of September, 1940, and at which conversation there was present Jehl, Mrs. Carrillo, and the bartender, Jehl was saying "he was kind of in the dumps", and Mrs. Carrillo "asked him what for", to which Jehl said, "I had to go to San Francisco, and get some of my men out of jail. It made me feel bad, cost me some money". "He said the men he got out of jail were arrested for running a still" (Tr. p. 39).

Della Carrillo testified that during the year 1940 she was employed at the Colonial Inn; that the defendant Jehl was her boss; that Jehl first came to the Colonial Inn in May of 1940 and remained until sometime in September of 1940; that the Colonial Inn was a night club; that about a week before Jehl left the Colonial Inn, that is sometime in September of 1940, she had a conversation with Jehl; that present were her husband, Joe Carrillo, and the bartender;

at that time Jehl said "that he had come to San Francisco to see about bailing out a couple of his men"; that prior to that conversation, sometime in the first part of August, Jehl said "it was awful to stand on a hill and watch thousands of dollars go to waste"; that she again saw Jehl shortly before the trial of this case; that Jehl came to the Colonial Inn with the defendants Rodrigues and Woodworth; that Jehl asked her if anybody had been to see her in regard to this case, and she said "Yes", and then Jehl said "Remember you don't know anything"; that on another occasion Jehl told the bartender, in the latter part of August, "that he had to go away for a little while because things were getting hot" (Tr. pp. 43-44).

Eugene E. Glorr, a physician and surgeon of Watsonville, California, testified that Jehl was a patient of his; that Jehl was being treated because of loss of weight, being nervous, and had a persistent cough, and he advised Jehl to seek a warmer climate; that he would not say the night club business would be good for his nerves or for the type of cough he had, sometimes one gave advice to patients that they do not necessarily follow.

Angelo Gordon Amizich testified that from the month of June, 1940 until September, 1940 he was employed as bartender at the Colonial Inn; that he did not hear any conversation, or conversations, as testified to by the Carrillos; that such conversations could have taken place without his hearing and without his knowledge (Tr. pp. 72-75).

Raymond H. Jehl testified, among other things, that he was and had been for many years engaged in the real estate and insurance business in the City of Watsonville; that in May of 1940 a Mr. Giorodoni came to his place of business in Watsonville and presented a card from Louis Hirsh, a jeweler who had a store in San Jose and Salinas; that he, Jehl, knew Mr. Hirsh for about twenty years; that on the back of the card was Jehl's name and address; that Mr. Giorodoni asked to be introduced to the Independent Grocer. Jehl introduced this man to Earl Goon. This man and Goon discussed the price of sugar, and later Giorodoni called on Jehl at the Colonial Inn in San Jose and requested Jehl to order, pay for, and purchase sugar in ten sack lots for Giorodoni. Jehl further testified that he did not know what Giorodoni wanted the sugar for and was surprised later to hear that Giorodoni was in the business of operating an illicit still.

Louis Hirsh testified that he lived in Salinas, California, and was engaged in the jewelry business; that he knew Raymond Jehl, and had known him for twelve or fifteen years; that he did not know a man by the name of Giorodoni; that he did not, during the months of April, May, or June of 1940, give one of his business cards to a man by the name of Giorodoni to be delivered to Mr. Jehl in Watsonville; that the week before the trial Jehl wanted him to remember the fact that he had given such a card to Giorodoni, and that he could not and did not know anything

about it; that he told Jehl to do so would be telling an untruth and that he would not do that.

Alex B. Hirsh testified that while he was at Big Sur on a Sunday shortly before the trial, he telephoned long distance to Jehl and told him not to try any longer to get in touch with his brother because he was not going to have anything to do with the matter that Jehl wanted him to take care of, and then Jehl said, "I don't want to talk about it over the telephone", and he told Jehl "Louis was not going to commit perjury for anybody".

ARGUMENT.

All of appellant's assignments of error relate to the sufficiency of the evidence to support the verdict. It is argued first that the evidence is insufficient to support the verdict as a whole, and secondly that, assuming the evidence to be sufficient to support the conspiracy count against appellant, there is no evidence to sustain the verdict on the substantive counts. On this particular point the law generally covering the same has been restated many times.

In the case of *Abrams v. United States*, 250 U. S. 616, 619, the Court said:

"The claim chiefly elaborated upon by the defendants in the oral argument and in their brief is that there is no substantial evidence in the record to support the judgment upon the verdict of guilty and that the motion of the defendants for an instructed verdict in their favor was

erroneously denied. A question of law is thus presented, which calls for an examination of the record, not for the purpose of weighing conflicting testimony, but only to determine whether there was some evidence, competent and substantial, before the jury, fairly tending to sustain the verdict." (Citing cases.)

In the case of *Vilson v. United States* (C.C.A. 9), 61 F.(2d) 901, this Court said:

"In consideration of the evidence on a motion for a directed verdict, the evidence must be considered in its most favorable aspect to the appellee. (Citing cases.) If there is substantial evidence it must be submitted to the jury, whose function it is to consider and weigh it, and this includes credibility of witnesses." (Citing cases.)

See also:

Stilson v. United States, 250 U.S. 583, 588;

Pierce v. United States, 252 U.S. 239, 251-252;

Crono v. United States (C.C.A. 9), 59 F.(2d) 339, 340;

Maugeri v. United States (C.C.A. 9), 80 F.(2d) 199, 202;

Cossack v. United States (C.C.A. 9), 82 F.(2d) 214;

Mullaney v. United States (C.C.A. 9), 82 F.(2d) 638-640;

Hemphill v. United States (C.C.A. 9), 120 F.(2d), at page 117.

This Court has constantly adhered to the rule as stated in the aforementioned cases.

The transcript shows the evidence against appellant to be most substantial and that appellant, together with his co-defendants, was certainly engaged in the operation of the illicit distillery, as charged in all of the counts of the indictment.

It is respectfully submitted that no other logical conclusion may be drawn from the testimony of the various witnesses as reflected in the transcript. The lease for the ranch, upon which the still was found, was entered into by appellant's co-defendants Rodrigues and Woodworth on the 9th day of March, 1940. Thereafter Rodrigues and Woodworth built a house upon the ranch premises (Tr. pp. 22-23). Electric service was connected on April 2, 1940. There was a normal consumption of electricity for the first three months, but in July and August, 1941 the consumption was above normal (Tr. p. 26).

The appellant, long in the real estate and insurance business in Watsonville, California, first went to San Jose and engaged in the night club business in May of 1940 (Tr. p. 43). Some time in May or June of 1940 appellant made arrangements to purchase sugar, at a price in excess of the regular price, in ten sack lots from Earl Goon. In all, six different sales of sugar were made by Earl Goon to the appellant between May of 1940 and August 1940 (Tr. pp. 33-34). This sugar was later picked up by the defendant Rodrigues, with one exception, when on one occasion the defendant Woodworth called and picked up the same. On at least three occasions the defendant Rodrigues paid for the sugar, the appel-

lant paying for the same on three occasions. When Rodrigues paid for the sugar it had already been ordered by the appellant. The appellant ordered the sugar in all instances (Tr. p. 34). Rodrigues and Woodworth were arrested on the still premises on the 28th day of August, 1940 (Tr. 16); the distillery was in operation. The defendant Rodrigues was in the still building mixing mash (Tr. p. 16). The defendant Woodworth on at least one occasion picked up sugar at the store of the witness Goon and delivered the same to the still premises (Tr. p. 57).

Thus we have from the evidence the leasing of the still premises by the defendants Rodrigues and Woodworth, the operation of the still itself by these defendants, the ordering and paying for the sugar used in the operation of the still by the appellant, and the same being picked up at the store on various occasions by appellant's two co-defendants.

Further, the appellant was engaged in the night club business in San Jose, California, from May 1940 until September 1940 (Tr. p. 43).

Some time in the latter part of August or first part of September, 1940 the appellant talked of "getting some of my men out of jail" in relation to "*my still*" (Tr. p. 39).

Shortly before the trial of this case, the appellant together with his co-defendants visited the witness Della Carrillo at the Colonial Inn, in San Jose, and the appellant asked Della Carrillo if anyone had been to see her in regard to this case. Della Carrillo

said "Yes", and appellant said to her, "Remember you don't know anything" (Tr. pp. 43, 44).

Thus, taking all of the facts in the case into consideration, they overwhelmingly tend to a most positive degree to establish appellant's guilt, not only on the conspiracy count, but on the substantive counts as well.

See the case of *Vukich v. United States* (C.C.A. 9), 28 F.(2d) at page 669, in which case this Court said:

"The only question to be determined in this case is whether a person who, with knowledge of the existence of an unlawful distillery, furnishes supplies thereto to be manufactured into contraband liquor, aids or abets the carrying on of such unlawful business. The business of a distillery cannot be carried on without supplies. *It follows that one who knowingly delivers supplies to such distillery aids and abets the carrying on of its unlawful business, and thus becomes, under the provisions of the statute, liable to be prosecuted and punished as a principal.*" (Italics ours.)

To the same effect see the case of *Borgia v. United States* (C.C.A. 9), 78 F.(2d) at page 555.

Also see the case of *Johnson v. United States* (C.C.A. 9), 62 F.(2d) at page 34, in which case this Court said:

"The evidence is sufficient to sustain the verdict of guilty on such last mentioned counts. *The fact that these appellants were not personally present at the place where and the time when the liquor was manufactured is immaterial. It is not*

necessary that one who aids and abets the commission of a crime shall be present when the crime is committed to sustain a conviction under this section." (Italics ours.)

Section 550, Title 18 *U.S.C.A.*, provides:

"Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces, or procures its commission, is a principal."

It is respectfully submitted that the evidence shows that appellant's actions were such in the present case as to place him squarely within the rule laid down by the above mentioned section and the above mentioned cases.

In support of his appeal appellant has cited five cases, one of which, to-wit, the case of *United States v. Sall* (C.C.A. 3), 116 F.(2d) 745, at 747, when properly interpreted in the light of the facts in the present case, is in full support of appellee's position herein.

In the case of *United States v. Cusimano* (C.C.A. 7), 123 F.(2d) 611, cited by appellant, it will be noted that the question presented to the Court was whether or not the president of an importing company, proven to have sold sugar to the operators of an illicit distillery with knowledge of the same, was properly guilty as an aider and abettor on the substantive counts of the charge, the Court holding that under the facts in the *Cusimano* case such conviction was

improper, though sustaining the verdict of guilty on the conspiracy count. The facts in the *Cusimano* case and the reasoning of the Court therein are clearly distinguishable from the facts in the present case, and thus of no assistance to appellant.

In regard to the other cases cited by appellant, none of them are in point with the facts in the present case, and also, therefore, are of no assistance.

Appellant testified in his own behalf in an effort to place an innocent construction on his proven actions in connection with the illicit distillery, and from the jury's verdict finding appellant guilty it is obvious his testimony was not believed.

CONCLUSION.

It is respectfully submitted that the evidence is sufficient to sustain the verdict of guilty on all counts in the indictment, and that appellant has shown no error, and that judgment should be affirmed.

Dated, San Francisco,
March 20, 1942.

FRANK J. HENNESSY,

United States Attorney,

VALENTINE C. HAMMACK,

Assistant United States Attorney,

Attorneys for Appellee.

No. 9905

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

RAYMOND H. JEHL,

VS.

UNITED STATES OF AMERICA,

Appellant,

Appellee.

APPELLEE'S PETITION FOR A REHEARING.

FRANK J. HENNESSY,
United States Attorney.

VALENTINE C. HAMMACK,
Assistant United States Attorney.
Post Office Building, San Francisco,
*Attorneys for Appellee
and Petitioner.*

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MAY 21 1942

PAUL F. O'BRIEN,
CLERK

Subject Index

	Page
Argument	5
Conclusion	7

Table of Authorities Cited

	Page
Quock Ting v. United States. 140 U. S. 417.....	6

No. 9905

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

RAYMOND H. JEHL,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S PETITION FOR A REHEARING.

*To the Honorable the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:*

Appellee respectfully petitions this Court for a rehearing in this case, following decision entered on April 21, 1942, in which this Court, through Haney, J., and Mathews, J., with Stephens, J., dissenting, held that the record disclosed no evidence directly or indirectly showing participation or knowledge, on the part of the appellant, with the activities of appellant's co-defendants, nor with the operation of the still referred to in the indictment, or any still, illicit or otherwise.

We have carefully considered the opinion rendered in this case by the learned Circuit Court. We have reached the conclusion that for the reasons hereinafter

stated the opinion is erroneous and in conflict with, and contrary to the evidence as reflected in the record.

Paragraph 3 of page 2 of the opinion of the learned Court is as follows:

“The evidence said to show appellant’s connection with the conspiracy and the operation of the still consists of testimony to the effect that on six occasions sugar was sold to appellant by a grocer in Watsonville, California, that portions of such sugar were delivered by the grocer to appellant and that portions thereof were delivered by the grocer to appellant’s co-defendants, but there is no evidence indicating that said sugar was used at or in connection with, or that it was purchased for, the still referred to in the indictment, or any other still, illicit or otherwise.”

It is respectfully submitted that such statement does not reflect the record, which on the contrary shows the evidence to be:

(1) That appellant made arrangements to purchase sugar in ten sack lots at a price in excess of the regular market price (Transcript, p. 33).

(2) That about three weeks later, appellant placed an order for ten sacks of sugar, and said that someone would pick it up. Subsequently, a day or so later, Rodrigues picked the sugar up (Transcript, pp. 33, 34).

(3) That on at least six occasions appellant ordered the sugar, which later would be picked up by Rodrigues, and on one occasion by Woodworth (Transcript, pp. 33, 34, 35).

(4) That on three occasions appellant paid for the sugar, and on three occasions Rodrigues paid for the sugar, but that on all of the occasions appellant had ordered the sugar, and that when Rodrigues paid for the sugar it had already been ordered by appellant (Transcript, pp. 34, 35).

(5) Sugar was found on the still premises at the time of the seizure of the illicit still and arrest of Rodrigues and Woodworth (Transcript, p. 27).

(6) Woodworth called for the sugar on one occasion. Appellant had ordered the sugar that Woodworth picked up (Transcript, p. 35).

(7) Woodworth hauled sugar from the Independent Grocery on one occasion to the still premises. That was in the latter part of July. He went to the Independent Grocery and saw Earl Goon, and picked up some sacks of sugar and brought them out to the Hall Ranch (Transcript, p. 57).

(8) The witness Earl Goon read in the paper about a still being seized by the federal officers on the Hall Ranch, and a few days later appellant came to Goon and told him not to worry, it was just a routine matter (Transcript, pp. 34, 35).

(9) The witness Della Carrillo, in addition to testifying in relation to a still and statements made by the appellant relating to getting some of his men out of jail who were arrested in acts pertaining to "my still", testified that shortly before the trial of this case, that is the trial of the present case in which appellant and his two co-defendants were charged, Jehl

asked her if anyone had been to see her in regard to this case, and upon the witness answering in the affirmative Jehl said, "Remember you don't know anything" (Transcript, pp. 43, 44).

(10) The appellant testified in his own behalf, and among other things, in attempting to explain his proven connection with the purchase of sugar testified that in May of 1940 a Mr. Giorodoni entered his place of business in Watsonville, presenting a card from Louis Hirsh, an old friend of appellant's, Mr. Hirsh being a jeweler in Salinas and San Jose; that on the back of the card was appellant's name and address; that Giorodoni asked to be introduced to the Independent Grocery; that appellant introduced this man to Earl Goon; this man and Goon discussed the price of sugar; and that later Giorodoni called on appellant at the Colonial Inn at San Jose on several occasions and requested appellant to order, pay for, and purchase sugar in ten sack lots. Appellant was unable to give any further information relating to the mysterious Mr. Giorodoni (Transcript, pp. 77, 78, 79).

Louis Hirsh testified that he was engaged in the jewelry business in Salinas and knew the appellant for twelve or fifteen years; that he did not know a man by the name of Giorodoni; that he did not, during the month of April, May, or June, of 1940, give one of his business cards to a man by the name of Giorodoni to be delivered to appellant (Transcript, pp. 96, 97).

ARGUMENT.

The evidence proved that the illicit still, being the subject matter of the indictment, was operated by the defendants Rodrigues and Woodworth on the Hall Ranch, and further that in the operation of the still sugar was used; that the appellant, during the period of time the still was in operation, was engaged in purchasing sugar from Earl Goon, which sugar so purchased would be picked up in the evening by either the defendant Rodrigues or Woodworth. True, the evidence does not place the appellant at any time personally upon the still premises, but that the appellant participated in the operation of the still, with knowledge, to the extent of purchasing sugar for the same is definitely established by the fact that the appellant, following the seizure of the still and arrest of appellant's co-defendants at the Hall Ranch, *called upon Earl Goon and told Goon not to worry, that it was just a routine matter.* From this it is obvious that appellant had a guilty knowledge of his participation in the operation of the still on the Hall Ranch, otherwise the seizure of a certain illicit still and arrest of certain men for the operation of the same on the Hall Ranch would have meant no more to appellant than it would to anyone else who had no knowledge of the same.

Further, appellant's guilty knowledge and participation in the operations of the illicit still are established by the fact that appellant, in addition to talking to the witness Della Carrillo on two or three occasions relating to a still, again contacted the witness

Della Carrillo in the company of his two co-defendants shortly before the trial of their case, and inquired if anyone had been to see the witness, and upon the answer being in the affirmative appellant warned the witness to remember that she did not know anything. Certainly, it is respectfully submitted, the actions of appellant in this matter alone are sufficient to establish his guilt.

It must further be remembered, as heretofore stated, that the appellant took the stand and testified in his own behalf; that the trial Court and the jury were thus presented with the opportunity of observing the appellant, his manner of testifying, and his demeanor while on the stand, and no doubt the verdict of the jury was based in part upon such appearance of the appellant on the stand. That this is proper is well established by the case of *Quock Ting v. United States*, 140 U. S. 417, at 420, in which the Court said:

“Undoubtedly, as a general rule, positive testimony as to a particular fact, uncontradicted by any one, should control the decision of the court; but that rule admits of many exceptions. There may be such an inherent improbability in the statements of a witness as to induce the court or jury to disregard his evidence, even in the absence of any direct conflicting testimony. He may be contradicted by the facts he states as completely as by direct adverse testimony; and there may be so many omissions in his account of particular transactions, or of his own conduct, as to discredit his whole story. His manner, too, of testifying may give rise to doubts of his sincerity,

and create the impression that he is giving a wrong coloring to material facts. All these things may properly be considered in determining the weight which should be given to his statements, although there be no adverse verbal testimony adduced."

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the record discloses substantial circumstantial evidence which required the submission of the case to the jury, and therefore it is respectfully submitted that a rehearing should be granted.

Dated, San Francisco,
May 20, 1942.

FRANK J. HENNESSY,
United States Attorney.

VALENTINE C. HAMMACK,
Assistant United States Attorney.

*Attorneys for Appellee
and Petitioner.*

CERTIFICATE OF COUNSEL.

I hereby certify I am one of counsel of record for Appellee and Petitioner in the above-entitled cause, and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact, and that it is not interposed for delay.

Dated, San Francisco,
May 20, 1942.

VALENTINE C. HAMMACK,
Assistant United States Attorney,
*Of Counsel for Appellee
and Petitioner.*

